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"I would favor some more public projects."

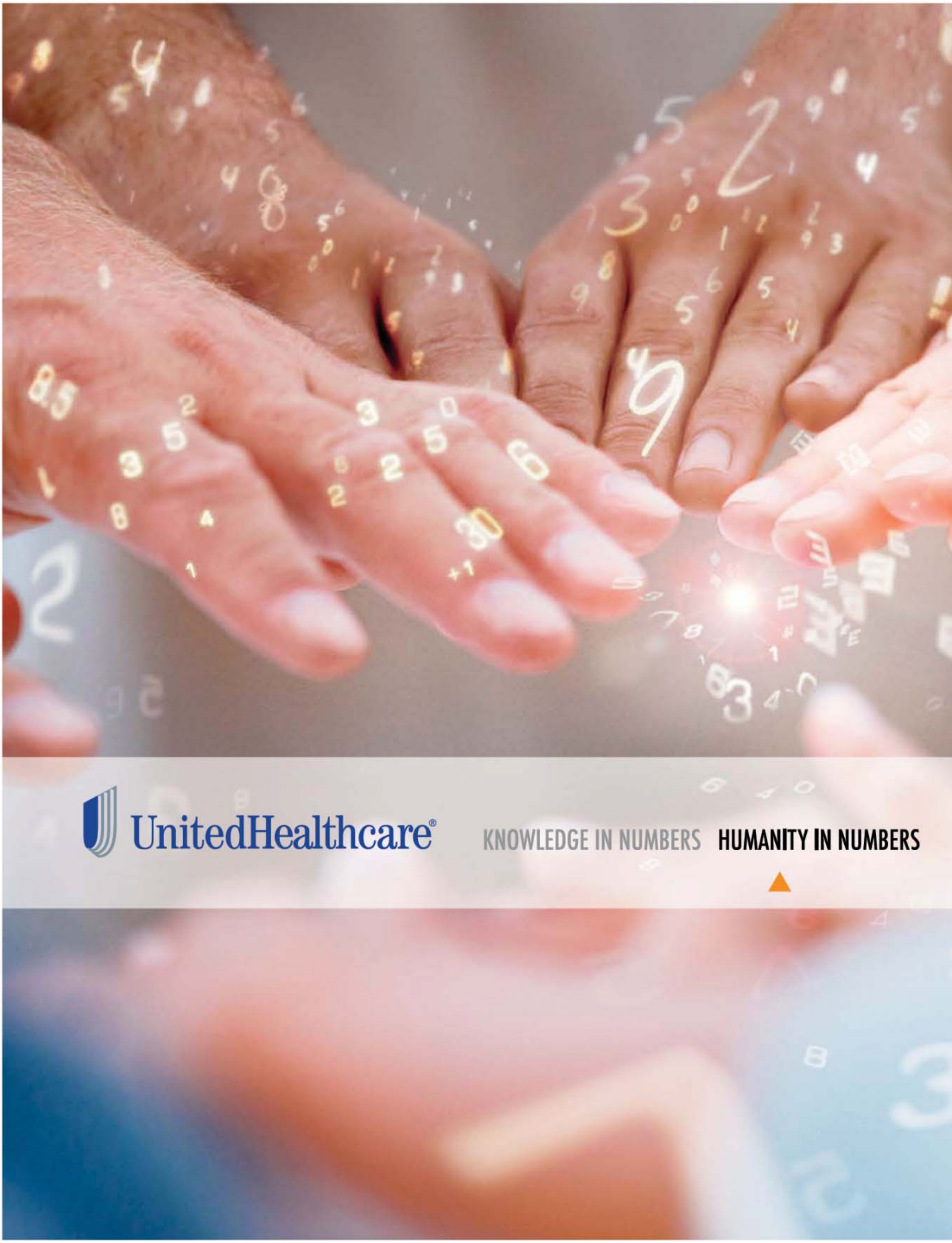
"I would focus on an infrastructure bank."

"Force a currency realignment to encourage China to develop internally."

"New Deal-type projects, because unemployment is sapping the national morale."

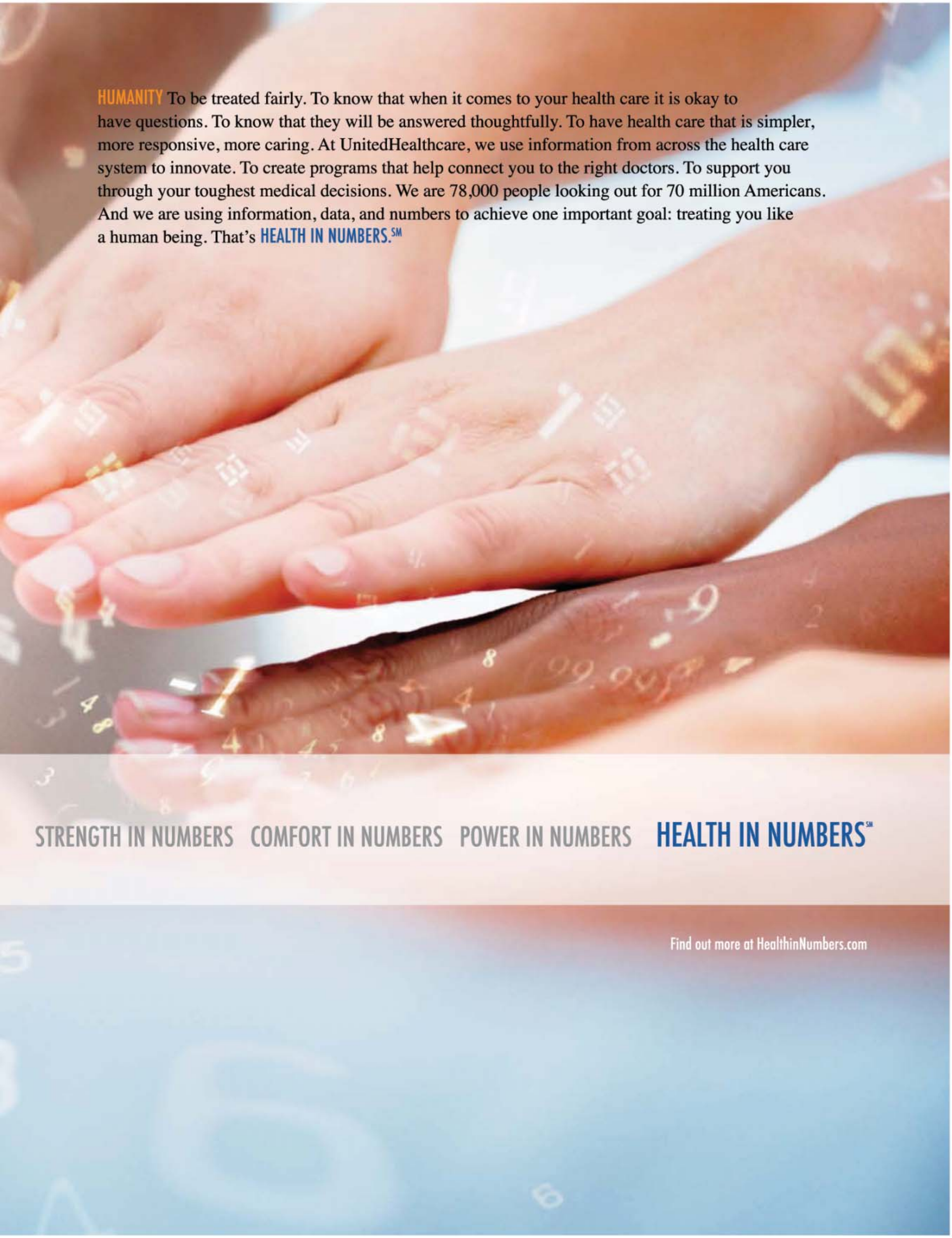
"I disagree! Nonsense! We are broke!"





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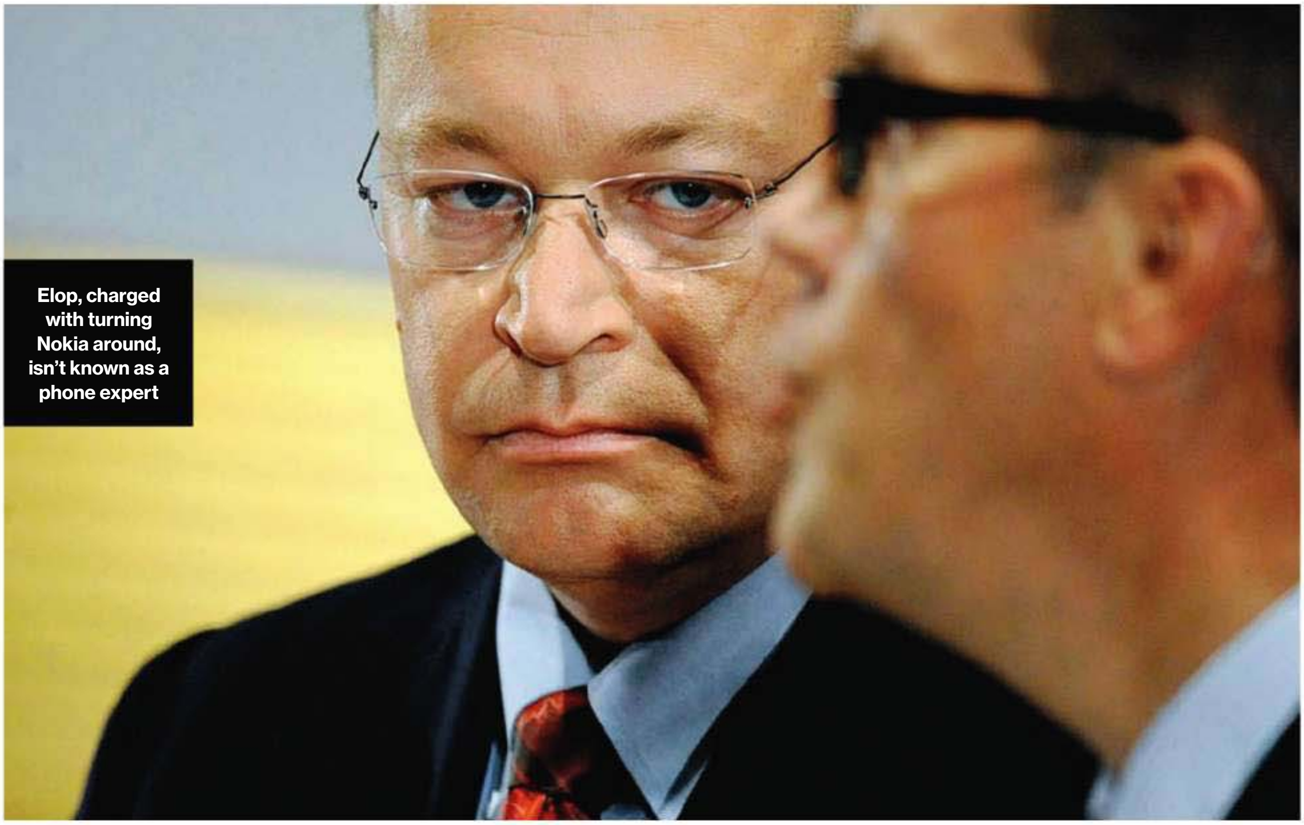


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Opening Remarks



Elop, charged with turning Nokia around, isn't known as a phone expert

LEHTIKUVA LEHTIKUVA/REUTERS

The Fallen King of Finland

Experts praised Nokia when it was on top. Now its slide toward irrelevance offers lessons for every executive on earth.
By Matthew Lynn

What was the most successful European company of the 1990s? Easy: Nokia. The Finnish mobile-phone manufacturer captured the emerging market for mobile phones and built the industry's most powerful brand. Its handsets virtually defined the industry from the time it launched its first GSM phone, the 1011, in 1992. From 1996 to 2001 its revenues increased almost fivefold, and by 1998 it was the world's biggest mobile manufacturer. In 2005 it sold its billionth handset, an 1100 to a customer in Nigeria.

Politicians lined up to praise Nokia as an example of how Europe could prosper in the 21st century. Romano Prodi, president of the European Commission, drew attention to the success of Nokia and its rival, Sweden's Ericsson, in a speech in 2002. "Their achievement in mobile telephones helped to create two vibrant clusters, around Oulu in Finland and Stockholm in Sweden, which have attracted a large number of startups as well as investment from foreign companies," Prodi said. "These examples demonstrate that European regions are capable of developing new, high-tech clusters."

Now, what's the most disappointing company of the 2000s? Easy again: Nokia. The company has been in steep decline—a point underscored by its Sept. 10 announcement that it was hiring its first non-Finn as chief executive officer.

Nokia clung to the idea that mobile handsets were mainly for phoning people. That was a disastrous call

Just as Nokia's rise held lessons about how Europe could succeed, its downfall tells us much about why European enterprises—and large companies worldwide—so often stumble. In the past three years, the news out of Nokia has only been bad. Since Apple introduced its iPhone in January 2007, Nokia shares have fallen 49 percent. In a ranking of global brands by Millward Brown Optimor this year, Nokia was No. 43, having dropped 30 places in 12 months. Its profit margins have been shrinking, along with its market share and the average price of its phones.

True, it still has more than one-third of global mobile-phone sales. But it's stranded in the middle of the market. Korean manufacturers such as Samsung Electronics are leading the main

Opening Remarks

Nokia should have relocated to California a decade ago. It would have caused an outcry—and would have been worth it

consumer market. Apple's iPhone and Research In Motion's BlackBerry dominate the upscale smartphone industry. Recognizing the scale of its challenges, Nokia hired Stephen Elop, the Canadian head of Microsoft's business unit, to turn the company around. Everyone will wish him well. (It takes a hard heart to root against the Finns.) But if the guy knows so much about phones, he's kept it a secret. Microsoft has never made any progress in that industry.

The cruel truth is that for all its residual market share, Nokia looks like a has-been. The company misread the way the mobile-phone industry was merging with computing and social networking. And it's probably too late to turn that around.

There are uncomfortable lessons here. First, success is not a sinecure. Nokia got to the top of its industry quickly. Once there, it became complacent. Under CEO Olli-Pekka Kallasvuo, Nokia worried about hanging onto market share rather than creating innovative products that excite customers. Second, Nokia was unwilling to challenge itself. The company clung to the idea that handsets were mainly about calling people. It failed to notice that they were just as much about checking your e-mail, finding a good restaurant, and updating your Twitter page.

Finally, Nokia wasn't located near a cluster of similar companies. Building a technology giant in Finland was a great achievement. But Nokia wasn't surrounded by Web companies or consumer-electronics manufacturers. That meant it wasn't in the mix of innovative ideas, which would have forced it to question its assumptions–and watch its back–every day. The harsh reality is that Finland isn't in the mainstream of Europe, never mind that of the global economy. Most of Europe's most successful industries are located in fairly tight geographic centers. Its pharmaceuticals industry is mostly in Basel and the southeast of England. Its luxury automobile industry is in Munich and Stuttgart. Its banking industry is based in London. There are exceptions–think of Airbus in Toulouse. More often than not, though, companies benefit from proximity to their competitors, poaching staff and swapping ideas. Isolation is bad for people, and bad for companies.

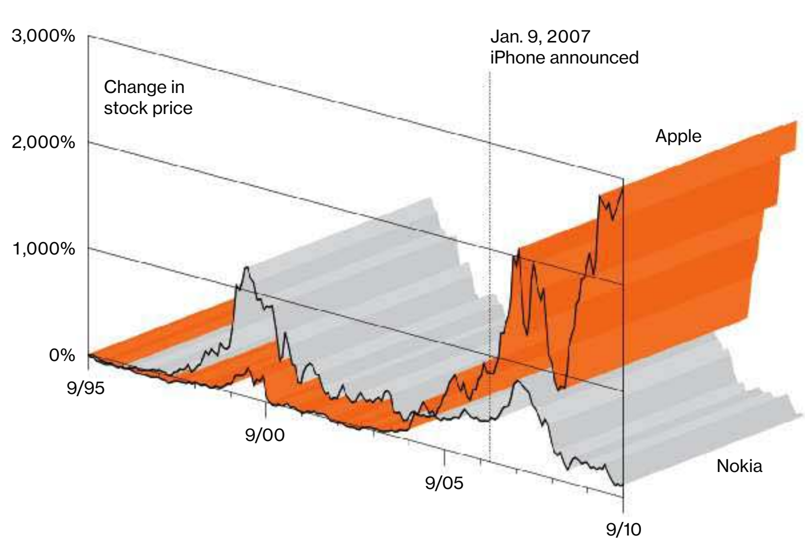
That's especially true for industries undergoing rapid change. Nokia needed to be right in the middle of the computing industry–and probably the film, music, and Internet businesses as well. We still don't know what kind of device the mobile will become. But it's far-fetched to imagine a business can keep up from the periphery of Europe. Nokia should have relocated to California a decade ago. It would have caused an outcry in Finland, and probably in Brussels as well. And it would have been worth it. Nokia needed to pitch itself into the cauldron of technological change. Maybe that way it could have held onto its brand leadership, rather than surrender it to a computer manufacturer that looked dead on its feet a decade ago.

Europe still has companies that dominate industries such as oil, aerospace, pharmaceuticals, automobiles, and financial services. All are prone to similar missteps. Are the auto manufacturers doing enough to prepare for the arrival of electric cars? Are the drug companies ready for the merging of computing and biotechnology? Are banks positioned for a decade when debt is steadily reduced, not increased? Probably not.

Politicians and business experts spent a lot of time praising Nokia and trying to learn from its rise. They should devote as much time to studying the lessons of its downfall. If they don't, much of the rest of European industry may be doomed to repeat its mistakes. And Europe can't afford to lose many more world leaders. Ⓑ

Finnish Line

Nokia shares have fallen 49 percent since Apple introduced the iPhone.



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"It's certainly a compromise, but an acceptable compromise" — Franz-Christoph Zeitler, Bundesbank

"They missed an opportunity to strengthen the banking system quickly" — Jeremy I. Stein, Harvard

After Basel, the Banks Are Not Safer

"The transitional times are much longer than anyone had expected" — Cory Gunderson, Protiviti

▶ A long phase-in for new capital and liquidity rules muddles future security

▶ "This is a tacit admission of how fragile the recovery is"

The Americans wanted tough rules, fast. The Germans pushed back. The British, Swiss, Japanese, and French joined the fray.

It's rare that international regulatory talks command such attention, let alone passion. Yet for once global bank reform is center stage. The Basel Committee on Banking Supervision, made up of bank supervisors and central bankers from 27 countries, has struggled in the Swiss offices of the Bank for International Settlements (above) to construct new rules of the road for a global banking industry that is just staggering out of the wreckage of the 2008 crisis. The rules they have devised could prevent another crisis or unwittingly set the stage for one.

The results, reached on Sept. 12, were new capital and liquidity rules that satisfy few. The committee set standards many banks will find hard to meet. Yet banks have up to eight years to comply with most of them and as long as 13 years for some. "They missed an opportunity to strengthen the banking system quickly," says Jeremy I. Stein, an economics professor at Harvard University and a former adviser to the U.S. Treasury Dept. "Before these implementation deadlines arrive, we'll probably have another crisis."

The FDIC's Sheila Bair pushed for a faster switch to the new rules as well as higher capital ratios

When the talks to tighten bank regulations started last year, central bankers and bank supervisors had to construct rules tough enough to prevent another financial crisis yet flexible enough not to strangle the banks. The main task was to increase banks' capital requirements. Those are the funds set aside by a bank to pro-

GEORGIOS KEFALAS/KEYSTONE/AP PHOTO

Global Economics



Fumigating a New Delhi apartment to slow the spread of disease

vide a buffer against the possibility that its assets lose some or all their value in a crisis. Here the Basel committee showed some backbone. It tripled the minimum capital a bank must hold in the form of common equity and boosted the share of capital a bank must hold in the form of preferred stock.

The banks, however, secured a long phase-in period with a powerful argument: Too much pressure on them to build up a capital cushion would curtail lending. That's because a bank can increase its capital ratio—the size of the safety buffer compared with all it assets—in two ways. It can sell more stock to increase the numerator of the ratio, or it can cut lending to reduce the denominator. When the Basel committee gave banks four years to comply with its first worldwide capital standards in 1988, many reduced lending, which caused a credit crunch.

Committee members didn't want to repeat that mistake, says Joseph R. Mason, a former bank regulator who teaches finance at Louisiana State University. "This is a tacit admission of how fragile the recovery of the world economy is," he says. Harvard's Stein counters that regulators could have gotten results quickly by limiting the amount banks could spend on executive pay and dividends until they raised new capital. That's what the U.S. did after stress-testing its 19 biggest banks and demanding $75 billion of fresh capital injections within six months. The banks managed to meet and even exceed the capital levels in two months, so eager were they to rid themselves of the restrictions on pay and dividends.

Sheila C. Bair, chairman of the U.S. Federal Deposit Insurance Corp., and Daniel Zuberbühler, vice-chairman of Swiss banking regulator Finma, pushed for a phase-in period of five years as well as higher ratios, according to participants in the meetings and others briefed on the discussions. Axel A. Weber, head of Germany's Bundesbank, wanted lower ratios—and 10 years to phase in the rules. Banks owned by Germany's regional governments are saddled with bad U.S. assets and local loans gone sour. They would need further bailouts to meet the new rules quickly. Germany's 10 largest banks (including some of the regional banks) would need more than $100 billion of fresh capital to comply, according to estimates by the Association of German Banks.

U.S. Treasury Secretary Timothy F. Geithner pushed for higher capital ratios, too, according to people close to him. Yet the U.S. had to heed others' concerns about the economy, one committee member says. "It's certainly a compromise, but an acceptable compromise," Bundesbank Vice-President Franz-Christoph Zeitler says.

It wasn't only Germany that won breathing space. Other European banks, such as France's **Crédit Agricole**, which might have been forced to raise fresh capital were the rules to go into effect sooner, will "benefit significantly from the delay," Credit Suisse wrote in a Sept. 13 report. "The transitional times are much longer than anyone had expected," says Cory Gunderson, head of global risk and compliance practices at Protiviti, a consultant to banks.

The committee also narrowed the definition of what constitutes common equity. Jamie Dimon, chief executive of **JPMorgan Chase**, said on Sept. 14 that due to the change in definition his bank's current common stock ratio would go from 10 percent to 7 percent. That would be the minimum acceptable level under the new rules. By holding onto some of its profits and by lending a little less and reducing some derivatives positions, JPMorgan aims to increase its common-stock ratio to 9 percent by late 2011, Dimon said.

One new rule, the liquidity coverage ratio—which ensures that a lender has enough cash or easy-to-sell assets to cover a month's worth of liabilities—faced much less opposition from bankers, who know that a lack of liquidity finished off Lehman Brothers and Bear Stearns. Yet the rule's starting point is early 2015 instead of the next year or two. "We were expecting earlier implementation, but to their credit, the regulators decided to take a harder look at it to make sure it doesn't have unforeseen consequences," says Mary Frances Monroe, vice-president for regulatory policy at the American Bankers Assn., the leading bank lobby. The unforeseen consequence could be delay of a rule that might prevent the next crisis.
—*Yalman Onaran*

The bottom line *The Basel committee imposed strict new capital rules to avoid another bank crisis. Yet the banks have a long time to comply.*

18

PERCENT

Estimated rise in home prices this year in Hong Kong, according to real estate adviser Knight Frank. Hong Kong authorities worry about the risks of a bubble.

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Health

In India, Dengue Fever Stalks the Affluent

- ▶ **Water tanks and flower pots breed mosquitoes**
- ▶ **"I've treated at least five CEOs this week alone"**

On the sixth floor of the modern, glass-fronted Max Institute of Medicine in New Delhi's upper-middle-class neighborhood of Saket, Dr. Sandeep Budhiraja is fielding calls on his iPhone from panicked patients, most of them members of India's elite. "I've treated at least five CEOs this week alone," he says.

Delhi's growing middle class and sliver of super-rich have ensconced themselves in the posh suburbs of south Delhi, where three-bedroom apartments sell for $1 million and tree-lined boulevards end at high-walled security gates. The maladies of the poor—malaria, tuberculosis, polio, and diarrhea—are rarely seen here. Every monsoon, though, south Delhi becomes the hub for dengue, a disease harbored in mosquitoes that flourish in the environment these entrepreneurs and executives crave—clean and lush, punctuated by public parks with pools and fountains.

"There's no doubt about it. In Delhi, dengue is a disease that spreads best in neighborhoods that only the upper middle class and rich live in," says Budhiraja, whose hospital is a stroll away from India's largest shopping mall. What makes south Delhi's suburbs more susceptible than the slums of north Delhi is that the *Aedes aegypti* mosquito, which transmits dengue, lays eggs almost exclusively in clean water that stands for days. That commodity, while rare in slums, is abundant in neighborhoods like Greater Kailash, Defence Colony, and Chanakyapuri, where residents store water in large tanks and cultivate gardens filled with flower pots.

Dengue causes fever, severe headaches, and muscle and joint aches for up to 10 days, according to the World Health Organization. It is the most widespread tropical disease after malaria. Dengue-related complications cause about 500,000 hospitalizations annually worldwide, mostly involving children. About 2.5 percent those hospitalized have a form of the disease that weakens blood cells and kills the patient through spontaneous bleeding and shock.

The Indian Health Ministry has confirmed 1,438 cases of dengue so far this season in Delhi. Budhiraja and other doctors say that number is low. Spokespeople and doctors at 15 hospitals contacted by Bloomberg News say they have already seen more than 3,300 cases. Indian newspapers have reported up to five deaths this season.

Unlike other diseases, dengue does not tend to decrease in incidence as tropical countries become wealthier. "Instead, the problem is often exacerbated," says Peter Ryan, head of the mosquito control laboratory at the Queensland Institute of Medical Research in Australia.

Research in Vietnam has shown that in areas without running piped water, the rich tend to hoard more water, says Ryan. People with 10 containers of fresh water in their houses are 10 times more exposed to dengue-carrying mosquitoes than poorer residents who may store water in a single bucket. In Delhi, where the municipal corporation supplies piped water for only two or three hours a day, the middle class and wealthy buy water pumps and tanks in which they store their daily requirements. In the slums of Jagdamba Camp and Sadar Bazaar, the congested living conditions, open sewers, and influx of migrants expose the residents to diseases like malaria, which breeds in filthy water.

Delhi's preparations for the Commonwealth Games, which will start on Oct. 3 and involve 71 countries, may have left south Delhi residents more vulnerable to dengue. The Indian government has spent at least $4.6 billion building or refurbishing subway

Quoted

"We have to erase forever the notion that Cuba is the only country in the world where one can live without working."
—Cuban President Raúl Castro, addressing the Cuban National Assembly



routes, stadiums, and roads. "Construction sites with tarpaulins that collect rainwater, pipes lying around, or even buckets are perfect for dengue," says Scott Ritchie, a medical entomologist at the Tropical Public Health Unit in Cairns, Australia. Fear of dengue has prompted the U.K., Canada, Australia, and New Zealand to advise its athletes in the Games to wear protective clothing and use mosquito repellent.

On Sept. 9, Anjum Khan, a 19-year-old resident of the exclusive enclave of Greater Kailash sat in a New Delhi hospital room waiting to be discharged after a week of receiving platelet transfusions and painkillers. The fashion-school student, her skin still pale and her breathing shallow, had switched hospitals twice as clinics and dispensaries ran short of the platelets prescribed in extreme cases like hers. "I am not sure where I caught it," says Anjum, while her mother packed her belongings. "I didn't know that the mosquitoes only liked clean water."

—*Mehul Srivastava and Jason Gale*

The bottom line *India's rising affluence is creating new opportunities for infectious diseases such as dengue, which needs clean, standing water to spread.*

Welfare States

Surprising Changes in Socialist Sweden



▶ In national elections, a conservative coalition could win a second term

▶ "Capital dares to stay in Sweden and dares to invest in Sweden"

Max Hansson remembers how much time he used to spend figuring out what taxes he and his company owed before a probusiness coalition won control of Sweden's government in 2006. Hansson, chairman of **PayEx**, a payment services provider, ticks off the levies that have since been lowered or abolished: payroll taxes. The corporate tax. The wealth tax. "Things have become very good in Sweden," he says.

So many other Swedes share Hansson's opinion that the ruling coalition of Prime Minister Fredrik Reinfeldt (left) and his Moderate Party has a good shot at winning a second term on Sept. 19. If that happens, Reinfeldt will be the first Moderate Party leader to gain a second term since 1908–an amazing feat, given the power of the Social Democrats.

The Social Democrats created Sweden's fabled welfare state, with its enviable cradle-to-grave benefits. Yet the cost of such largesse kept rising. Reinfeldt came to power by convincing voters that lowering income taxes and benefits would increase the number of jobs and actually boost the tax revenues necessary to keep the welfare state intact. Once in office, Reinfeldt's coalition cut income taxes by 70 billion kronor, or about 2.3 percent of gross domestic product; tightened the budget; and trimmed jobless benefits to nudge people back to work. Reinfeldt has stressed gradual change, not the wholesale attack on the welfare state that earlier conservative leaders had called for.

The economy has cooperated. After contracting last year, GDP will probably grow 4.5 percent this year, making Sweden one of Europe's top performers. The country's exporters, like Germany's, have thrived as Asia's appetite for heavy equipment and so-

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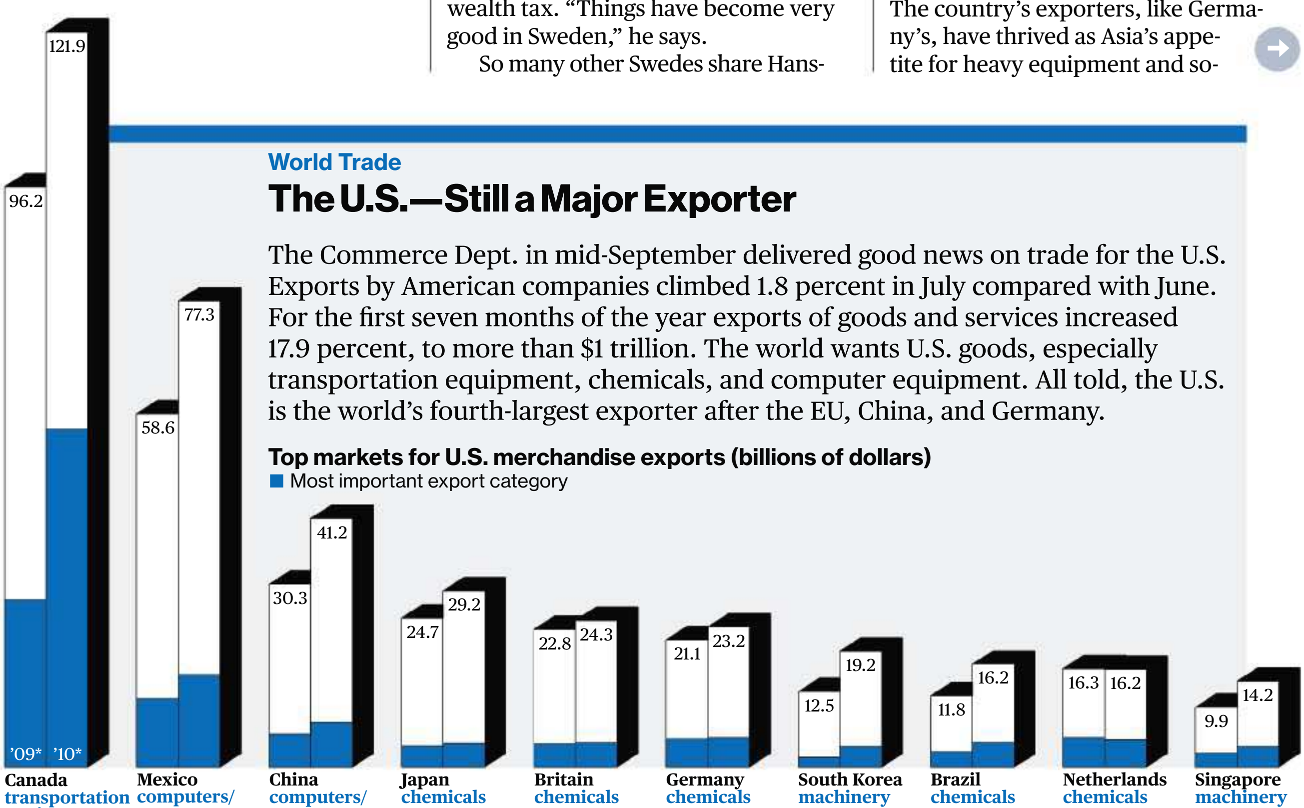
World Trade

The U.S.—Still a Major Exporter

The Commerce Dept. in mid-September delivered good news on trade for the U.S. Exports by American companies climbed 1.8 percent in July compared with June. For the first seven months of the year exports of goods and services increased 17.9 percent, to more than $1 trillion. The world wants U.S. goods, especially transportation equipment, chemicals, and computer equipment. All told, the U.S. is the world's fourth-largest exporter after the EU, China, and Germany.

Top markets for U.S. merchandise exports (billions of dollars)

■ Most important export category



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phisticated consumer goods increased. The ruling coalition this year will likely deliver the smallest budget deficit in the region. "The fiscal story is certainly better than the rest of Europe," says Jonathan Fayman, a fund manager at BlueBay Asset Management in London, which oversees about $38 billion.

The Social Democrats have tried to convince voters that Reinfeldt's coalition is much more conservative and scarier than it lets on. Yet the Moderate Party-led alliance holds an eight-point lead in polls, which points to a government victory in the election, says Sören Holmberg, a political science professor at the University of Gothenburg. "The focus has been on taxes and the economy," he says. "White-collar workers, primarily from the big cities, have deserted the opposition for the government."

The Moderate Party's decision to abolish the wealth tax, which nicked 1.5 percent of a citizen's assets above $215,000, has appealed especially to the affluent. Christer Gardell is founder of investment firm **Cevian Capital**, which controls 5.5 percent of the voting rights in truckmaker **Volvo**. He says eliminating the tax has been the "most important change" the government has made, since it means "capital dares to stay in Sweden and dares to invest in Sweden." Reinfeldt wants to cut taxes by an additional $4.2 billion if he wins.

One wild card is the extreme right, which is strongly anti-immigrant and has been accused of espousing racist ideologies. The right-wing party, known as the Swedish Democrats, may secure seats in Parliament for the first time. If the conservatives don't win outright, the Swedish Democrats may try to play kingmaker in any effort to form a government. Reinfeldt's alliance has sworn it will not cut any deals with the hard right and will turn to the Green Party instead.

—Johan Carlstrom and Tasneem Brogger

The bottom line *Sweden's voters, known for their left-wing tilt, may reelect a tax-cutting, fiscally hawkish conservative government.*



Nissan factory in Japan: The country's exporters want a lower yen

Currencies

When Everybody Exports, Nobody Wins

▶ Japan's yen intervention may be a bad omen for global trade

▶ "Everyone wants to export their way out of trouble, and can't"

On Sept. 15, Japan sold yen for dollars to slow the yen's climb to a 15-year high against the dollar. Japan decided to take on the market to protect its exporters from the devastating impact of the super-yen. It's a logical move, from Japan's point of view. Yet it exposes a flaw at the heart of the current global recovery effort: The world's major industrial economies can't all export their way to prosperity.

Governments from Tokyo to Washington are counting on exports to keep their economies growing at a time of painfully high jobless rates and record budget deficits. The danger is that the race to hand companies such as **Hitachi** and **Boeing** an edge in the international marketplace will lead to a series of currency devaluations and protectionist measures that threaten global growth–a reprise of the 1930s-era beggar-thy-neighbor trade policies

Drawing Board



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The WNBA makes history, not profits page 22 ▶

that worsened a global depression.

The Japanese acted as U.S. lawmakers convened hearings to pressure China into letting the yuan appreciate and as the European Commission urged Germany to lower its reliance on foreign demand for growth. "There's a basic dilemma for the world as everyone wants to export their way out of trouble and can't," says Jim O'Neill, chief economist at Goldman Sachs in London and incoming chairman of Goldman Sachs Asset Management.

Japan unilaterally sold yen for dollars in the currency market following complaints from business leaders that the rapid appreciation of the yen was proving difficult to manage. Trade accounted for more than half of Japan's economic growth in the second quarter. The yen, which gained about 11 percent against the dollar in the four months prior to the intervention, slid 3.1 percent, to 85.6 per dollar, after the intervention. The Nikkei gained 2.3 percent on the news.

The Bank of Japan's move may not be an isolated event. What we may be looking at, says Robert Doll, chief equity strategist at BlackRock, is "trade scapegoating" as politicians try to boost their domestic economies. The U.S. House Ways and Means Committee, for example, is debating whether to seek trade barriers against China.

Meanwhile, Beijing has limited the yuan's gains to less than 2 percent against the dollar since June, when it signaled it would allow a more flexible currency. Even so, China may seize on Japan's intervention to counter U.S. lobbying for a further yuan appreciation, says Ashraf Laidi, chief market strategist at CMC Markets in London. The effort to weaken Japan's currency "is obviously a negative for their euro-zone competitors, notably Germany," says Stefan Kolek, a Munich-based strategist at UniCredit.

Germany has itself been criticized for not doing enough to rebalance the world economy. Billionaire investor George Soros and Nobel laureate Joseph Stiglitz say Chancellor Angela Merkel should spur domestic growth rather than lecture others about the virtues of fiscal austerity. Trade accounted for more than a third of German growth in the second quarter. Germany's reliance on exports is "contributing to a huge trade imbalance on the euro zone's periphery," Juergen Kroeger, a director at the European Commission's Economic and Financial Affairs Dept., said on Sept. 13.

Meanwhile, President Barack Obama vows to double U.S. exports over five years. Policymakers in Malaysia, Thailand, the Philippines, and South Korea have signaled they may also act to limit currency volatility, and the Swiss National Bank has already done so. Trouble is, says Simon Evenett, professor in international trade at the University of St. Gallen in Switzerland, "Someone's exports are another country's imports, so they can't all win." —*Simon Kennedy*

The bottom line *With major economies aiming for export growth, the temptation will be great to rely on protectionist measures.*

U.K. Austerity

Cameron's Budget Thrills Bond Buyers

▶ A pledge to shrink the British deficit sends prices sky-high

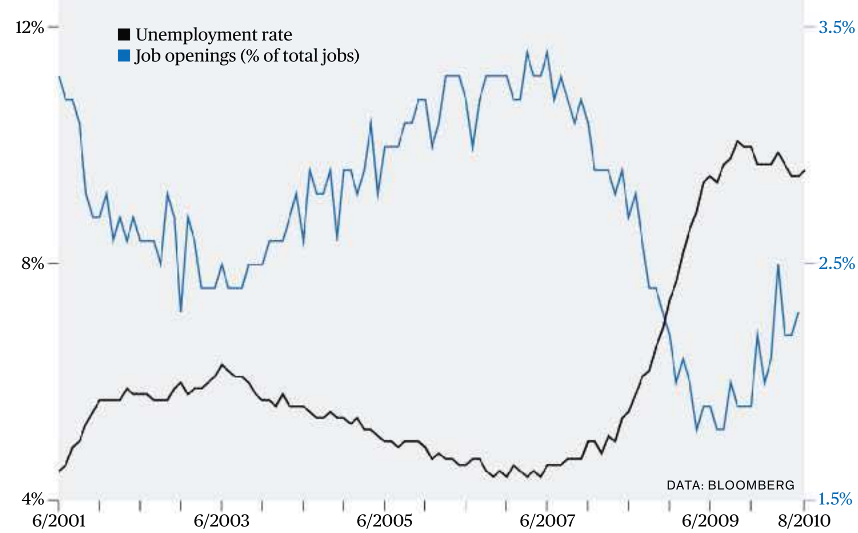
▶ "It's better to tackle deficits than just keep spending and spending"

British Prime Minister David Cameron's coalition government is pushing cuts and austerity measures worth £30 billion ($46 billion) a year to shrink Britain's 11 percent deficit to 2.1 percent by 2015. Chancellor of the Exchequer George Osborne has not spelled out the details—those are to come in a "Comprehensive Spending Review" on

Unemployment

Jobs Are There, Qualified Applicants Aren't

Companies can't find enough qualified workers to fill positions, according to Narayana Kocherlakota, president of the Minneapolis Fed. He estimates that the current job opening rate of 2.3 percent of U.S. workers should translate into a jobless rate closer to 6.5 percent than 9.6 percent. Companies need a variety of technical workers, while many unemployed were trained to work in construction and other housing-related jobs. Says Kocherlakota: "It is hard to see how the Fed can do much to cure this problem."
—*Joshua Zumbrun*



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Global Economics



Oct. 20. As for the impact of the cuts on ordinary Britons, that won't become apparent until well into 2011.

The bond markets, however, have feasted early on the prospects of a painful budget. Gilts, or government bonds, have returned 2.24 percent in the quarter. U.K. corporate bonds in all currencies have returned 4.97 percent so far this quarter, the best record among the biggest issuers of company debt.

If the Liberal-Conservative coalition holds, Osborne should get his budget

The markets are betting that Cameron's bold moves will preserve Britain's AAA credit rating without slowing the economy so much that it curbs the ability of companies to meet their debt payments. "Investors are happy with the measures taken," says Christian Weber, a senior credit strategist at UniCredit in Munich. "The perception has spread that it's better to actually tackle budget deficits than just keep spending and spending and spending, because that limits your ability in the future to help your economy stabilize."

As the coalition government approaches the moment when the grim details become public, things could get contentious. On Sept. 13 union leaders urged the British public to join millions of workers in a campaign to halt the steep budget cuts. "Industrial action is inevitable unless the government is prepared to change direction," Mark Serwotka, general secretary of the Public and Commercial Services Union, told delegates. A total of 490,000 public-sector jobs will be lost by April 2015 under the measures being planned by Osborne, according to U.K. Treasury estimates.

As long as the coalition of Conservatives and Liberal Democrats holds firm, Cameron and Osborne should be able to push the budget through Parliament. Bond investors are watching carefully: Ten-year gilts have already retreated some from their August highs. B

—*Bryan Keogh*

The bottom line *British government bonds have benefited from the draconian budget proposed by the Tories. Protests, however, could be widespread.*

Seven Days



20

UBS Global Life Sciences Conference

Anniversary of George W. Bush's declaration of war on terror in 2001

▶ **U.N. General Assembly:** Meetings begin in New York. President Obama and Chinese Premier Wen Jiabao plan to talk on the sidelines. Iranian President Mahmoud Ahmadinejad will likely skip disarmament talks.

21

Federal Reserve Open Market Committee meeting

U.S. housing start numbers for August



▶ **AutoZone earnings report:** Although shares hit a record intraday high of $221.57 on Sept. 9, Wall Street expects slowed sales growth at stores open for at least a year.

22

New Zealand's second-quarter GDP announcement

Earnings reports from General Mills and Bed Bath & Beyond

▶ **Germany's Leading Economic Index:** The Conference Board releases July figures. The German index has ticked upward for seven straight months.

▶ **Thirty years ago:** War broke out between Iran and Iraq.



23

U.S. existing home sales

Nike earnings report



▶ **Rite Aid earnings report:** After three years of losses, the drugstore chain is a likely takeover target.

▶ **Clinton Global Initiative:** First Lady Michelle Obama closes the four-day conference in New York.

24

KB Home earnings report

U.S. durable-goods orders for August

▶ ***Wall Street: Money Never Sleeps*** Oliver Stone's sequel to the 1987 film hits theaters. Michael Douglas returns as Gordon Gekko, now hawking his book, *Is Greed Good?*

25

Diaghilev show opens at the V&A museum of decorative arts in London



▶ **Oktoberfest:** Munich's 200th annual festival of beer, pretzels, and lederhosen reaches its midpoint. Six million visitors are expected.

26

Gold Star Mother's Day honors U.S. moms who have lost a son or daughter in military service.

▶ **PGA Tour Championship:** Thirty top-ranked golfers compete for a $7.5 million purse on the last day of the final leg of the FedEx Cup at East Lake in Atlanta.



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Contents ▶ The WNBA's historic—but not profitable—year 22 ▶ The kings of crowdsourcing branch out 24 ▶ Pepsi's edge over Coke in India 26 ▶ Designer duds for kids take off 27 ▶ Briefs: An IPO for Chinese couch potatoes? 28 ● Edited by James E. Ellis

Netflix: Premium Cable's Worst Nightmare



▶ **Fast growth and pricey deals have made the service the first Web-based movie channel**

▶ **Recognizing "there is a value in exclusivity," HBO won't allow its series to be streamed on Netflix**

Hollywood is having a hard time deciding if **Netflix** is friend or foe. The fast-growing movie service has already helped drive DVD retailer **Blockbuster** to the brink of Chapter 11. Now, Netflix is poised to take on premium cable giants like HBO and Showtime. Last month, Netflix bought the rights to stream films from three studios. That will make it the first true Web-based movie channel. It already has 15 million subscribers and an ad-hoc distribution network that includes Web-ready TVs like **Sony**'s Bravia, game consoles like **Microsoft**'s Xbox 360, and even gadgets like **Apple**'s iPad. That makes Netflix's $8.99 a month mail-order and online service a threat to more-expensive premium cable channels. It also poses a quandary for HBO parent **Time Warner**, whose Warner Bros. studio has become more reliant on Netflix as a source of revenue as overall DVD sales have declined. Netflix "is a customer for our output, and it is a potential competitor to networks like HBO," Time Warner CEO Jeff Bewkes said last month. "So far it has been more of a complementary service to HBO than a competitor."

That's changing. Netflix's most recent deals have moved it from the periphery of the home-entertainment ecosystem into the center of a world in which consumers can watch films and TV shows anytime and anywhere. On Aug. 10 it agreed to pay $900 million for online rights to films from the new Epix pay-TV channel, giving it streaming rights to 3,000 or more films from **Viacom**'s Paramount Pictures, **Lions Gate Entertainment**, and MGM. That raised Netflix's total to more than 20,000 films and TV shows. (It already had rights to some shows from **CBS**'s Showtime, and movies from **Walt Disney** and Sony via a deal with the Starz pay channel that expires late next year.)

Three weeks later, Apple Chief Executive Steve Jobs announced that Apple will use Netflix to stream movies through its Apple TV device as well as the iPhone and iPad. Since then, Netflix' shares have jumped 14 per-

ILLUSTRATION BY TOPOS GRAPHICS; STEVEN ERRICO/GETTY IMAGES

Companies&Industries

cent to about $143 a share. "The value of Netflix continues to grow," BTIG Research analyst Richard Greenfield observed recently. "Adding a premium TV channel to your cable subscription can cost $10 to $15 a month, in contrast to Netflix for as little as $9 a month."

Netflix won't instantly remake the cable landscape. It has more than 15 million subscribers; HBO and its sister channel Cinemax together had 41 million U.S. subscribers at the end of 2009. And it's still no snap to stream shows from the Web to the living room TV. But the explosion of Net-ready gear will help (chart). Already, more than 61 percent of Netflix customers have streamed movies, the company says, up from 37 percent a year ago. As its subscriber base grows–Barclays Capital analyst Anthony DiClemente projects membership will jump 43 percent in 2011, to 26.4 million–so too will its clout.

Chief Content Officer Ted Sarandos says Netflix isn't out to topple the cable incumbents, whose parent companies control the online rights to many of the movies Netflix needs. "We see ourselves as complementary," says Sarandos. "If someone loves *Weeds* on Showtime, they'll watch it on Showtime and go find the older episodes from us."

Still, the pay channels are taking no chances. They're beefing up original programming, like HBO's *Boardwalk Empire* and Showtime's *The Big C*, and keeping much of it in-house. For instance, to give its customers first dibs on its shows, Showtime doesn't release episodes of its comedy *Weeds* to Netflix for streaming until months after they air. Epix requires Netflix to wait 90 days before streaming its new movies and TV shows.

HBO, the largest premium cable channel, takes an even harder line: It won't license any of its films or original series, like *The Sopranos*, for Netflix to stream. HBO also holds the rights for up to eight years to some films from Twentieth Century Fox and Universal Pictures–which could slow Netflix's advance. "There is value in exclusivity," says HBO co-President Eric Kessler. "Consumers are willing to pay a premium for high quality, exclusive content." HBO will battle Netflix on the Internet as well, and by early 2011 expects to make its new HBO Go online service available to its subscribers nationwide. The service, which provides 800 hours of TV shows and movies a month, is available to HBO's subscribers with **Comcast** and **Verizon**'s FiOS video service.

Netflix can counter with 46 percent of the films released last year, says Sarandos, including independent titles like *The Girl with the Dragon Tattoo*. HBO points out that it has seven of last year's 10 best-selling flicks. None of that matters if Sarandos can sign a deal with HBO, which he says he still hopes to do. "We're buyers and they're sellers," he says. "That's what we do." —*Ronald Grover*

The bottom line *As more home entertainment gear becomes Web-ready, Netflix is poised to become the first true online rival to cable movie channels.*

Cutting the Cord

New devices are bringing movies and TV shows directly into the living room, without a cable subscription



Apple TV	Xbox 360	Sony Bravia TV	Samsung Blu-ray disc
Web-to-TV interface box	Game consoles	Internet-ready TV	Internet-connected DVD player
Apple recently cut the price to $99 and added streamed movies from Netflix and 99¢ TV shows to rent. For true Apple fans, it will also stream movies from an iPhone or iPad to a TV. Roku's video device works similarly.	Gamers can switch from blasting aliens to streaming movies from Netflix to their TVs, watching ESPN's *Sports Center*, or renting TV shows. Sony's Playstation 3 and Nintendo's Wii offer similar Web streaming.	Like the newest models of most TV makers, Sony's connects to the Internet wirelessly to allow downloading of shows from Amazon and streaming of Neflix films. On the horizon: streamed Sony movies before they hit DVD.	Many Blu-ray players priced at less than $250 now offer easy-to-connect access to the Internet. Samsung's newest models offer movie rentals from Blockbuster and video streaming from Netflix via Wi-Fi.



ABOVE: PHOTOGRAPH BY CHRIS RANK FOR BLOOMBERG BUSINESSWEEK; RIGHT: RYAN ANSON/BLOOMBERG

Sports

WNBA Owners Make History, Not Profits

▶ Both women's league finalists have female owners

▶ "There are charity banquets that generate more...than a WNBA team"

The moment the WNBA Finals finish, the top U.S. professional women's basketball league will have written a new chapter for the record books. The winner in the five-game series that started on Sept. 12, whether it's the Atlanta Dream or the Seattle Storm, will be the first female-owned champion in the league's 14-year history. A second milestone–making a profit–might prove to be a bigger hurdle. "The truth of the matter is, there are charity banquets that generate more dollars than a WNBA team," said Bob Hope, an Atlanta public-relations executive who last year helped broker the sale of the city's Dream to the current owner, Kathy Betty, 54. "It's clearly a challenge."

Betty, a former partner at accounting firm **Ernst & Young**, says she didn't buy the team solely as a money-making investment. When Hope and other local business leaders approached her last

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Betty aims to become the first owner of a profitable WNBA team

year about buying the team, "I laughed," she said during an interview at the team's practice facility. "It's the worst economy in my lifetime, we're in a recession, and he wants me to buy a sports team?" Yet following the 2007 death from cancer of her husband, former **EarthLink** Chief Executive Officer Garry Betty, she says she was in need of a new passion. So after some soul-searching, the longtime sports fan gave in.

Even Dream coach Marynell Meadors, who earned 2009 WNBA Coach of the Year honors after guiding the team to an 18-16 record following a 4-30 rout in its inaugural season, scratched her head over Betty's decision to purchase the club last October. "It made no [economic] sense," Meadors said. "But it's perfectly clear why she did it: She wanted to empower women." Betty also says she wants to be the first WNBA owner to turn a profit. She wouldn't disclose the financial terms of her purchase of the team from Ron Terwilliger. Other WNBA franchises have sold for about $10 million.

Storm co-owner Dawn Trudeau bought the Seattle team in January 2008, as part of a four-woman group, to prevent the club from leaving town with the NBA's SuperSonics when that team moved to Oklahoma City. Like Betty, she hopes the purchase will provide role models for local girls. Recording a profit, however, won't be as easy. "We're still in the red," Trudeau said. "But we have a multiyear plan for how we are going to build the business and get in the black."

She declined to reveal specifics, but other WNBA teams, including the Dream, are wooing corporate sponsors as well as trying to get dads and their daughters to become season ticket holders. Making it to the finals has helped, Trudeau said. "We don't budget for being in the playoffs," she said. "So we are overachieving on ... our overall march towards profitability."

Trudeau, who spent 14 years as a manager at **Microsoft**, wouldn't comment on when she expects the team to turn a profit. Capitalizing on its owners' ties to **Microsoft** (another co-owner is Lisa Brummel, senior vice-president for human resources at the tech giant), the Storm's jerseys are sponsored by Bing, the software company's Internet search engine. "It isn't something you would enter into if you're trying to make a lot of money," Trudeau said. "It's something you're doing because you have a love for the game, your community, and what this says to the world."

This season average attendance at Storm games rose 5.7 percent, to 8,332, fifth-highest in the 12-team league, according to *SportsBusiness Daily*. Trudeau declined to provide season ticket sales figures. It's been tougher for the Atlanta team. The Dream lost $3 million in its first season, *The Atlanta Journal-Constitution* reported last December. Attendance has declined every year since. This season's average of 6,293 for 17 games marked an 11.4 percent decline from a year earlier, the second-biggest drop in the league behind the Washington Mystics (17.5 percent) and off 25.9 percent from the inaugural 2008 season.

In her first full year as owner, Betty said she has been "drinking through a firehose" and hasn't had time to actively pursue other investors to share her financial load. Asked if she has a gender bias regarding potential investors, Betty smiled and said, "I probably shouldn't comment on that because it could hurt me. But do I have a preference? Yes."

The financial risk Betty took helped inspire her players this season. "She's like a true leader," said Dream center Yelena Leuchanka. "For her to make a decision like that in a bad economy takes a lot of faith. Having an owner who has faith in us, it helps."

A self-described "sports fanatic" who played basketball, baseball, and football while growing up in Decatur, Ala., Betty says owning the Dream gives her more of a thrill than simply being a fan. Yet now that she's reached the finals in her first year of ownership, Meadors wonders how high her boss's expectations will be in future seasons. "She might get used to this," the Dream coach said. "It's not going to be this good every year."
—*Michael Buteau*

The bottom line *With both teams in this month's WNBA finals owned by women, the league will make history. Logging profits will be more difficult.*

Quoted

"The decisions so far have not resulted in either job growth or increased confidence. Swimming pools in Mississippi are not going to create lasting jobs."
—Paul Otellini, CEO of Intel, on his disappointment with much of President Obama's stimulus spending



SOURCE: *CNNMONEY*

Enterprise

T-Shirts Are Just the Start For Threadless

▶ The crowdsourcing pioneer is branching out through partnerships

▶ "This is art that resonates with Dell customers"

Jake Nickell and Jacob DeHart, a pair of college dropouts from Chicago, had been running **Threadless** for six years before someone coined a term to describe the company's business model in 2006—crowdsourcing. Part apparel maker and part social network, Threadless has a website where artists can submit designs for T-shirts and have them voted on by a community of followers. The ones that garner the most votes are printed and sold for between $18 and $24 apiece. Artists receive a $2,000 payment and a $500 credit for purchases at the site. Since it churns out only those products that it knows customers want, Threadless has been profitable from its inception.

Now the company is out to prove its moneymaking strategy works on more than just Tees. In July computer maker **Dell** unveiled 12 new designs that can be etched onto the exteriors of its notebook PCs for an additional cost of $85. The images, which range from a scene in London to a deer with cherry blossoms growing out of its antlers, were all vetted by Threadless devotees. The designs have caught on quickly, according to Dell, which won't give specific sales figures. "We wanted to bring the voice of the consumer in, so teaming with Threadless was an obvious fit," says Rachna Bhasin, general manager of strategic partnerships at Dell. "This is art that resonates with Dell customers."

Earlier this year, Havaianas, the now ubiquitous brand of rubber flip-flops made by Brazil's **Alpargatas**, partnered with Threadless on a special line of sandals. For its first foray into the accessories arena, Threadless received more than 600 design submissions from contestants around the world. Sandals bearing the six winning motifs went on sale on Havaianas' website in July. Neither company will comment on how revenue is shared, but Jim Anstey, Havaianas' U.S. marketing director, says the Threadless line is now its No. 2 best-selling category online. "We were looking for a way to engage our target audience," says Anstey. "Conventional advertising doesn't work anymore."



One of the most popular Tee designs from Threadless

More established companies also have experimented with crowdsourcing. In 2002, **Mars** ran a global contest to choose a new color for its M&M's candy, with more than 10 million chocolate lovers taking part (purple



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triumphed). And in 2003 more than 360,000 ice-cream aficionados voted to add Primary Berry Graham to Ben & Jerry's lineup of flavors.

Threadless, however, is more than a one-off marketing stunt. "We're not telling people to make a design about theme X or Y," says Tom Ryan, the chief executive officer of Threadless parent company **skinnyCorp**. "We're letting them submit art and talk about what they find interesting."

The Threadless formula relies on designers to spread the word about the site's products. Jess Fink, an artist from upstate New York who has five winning entries to her name, campaigns for votes by posting links on her blog, Twitter, and personal website, all of which helps drive traffic to Threadless' site. Says Fink: "Threadless draws in people who know how to create real, quality work—who are not just trying to make a quick buck."

Ryan won't say how much revenue the company has derived from partnerships, nor will he reveal overall sales. He does say annual revenues are growing at double-digit rates. Overhead costs are minimal: The company employs just 51 workers full-time in Chicago, largely limits its advertising to social networks such as Facebook, Digg, and Twitter, and recruits customers and employees to model the T-shirts on its site.

Threadless' edge: the community that it has nurtured. The site has logged 2.5 million unique visitors this year, a 50 percent increase over the same period last year, according to Ryan. "Threadless is an archetypal crowdsourcing company," says Jeff Howe, author of *Crowdsourcing: Why the Power of the Crowd Is Driving the Future of Business*. "They really redefined customer service and marketing as a much deeper, richer process, as opposed to a simple and straightforward means."

In addition to Dell and Havaianas, Threadless designs have ap-

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For Ahmed Mady, owner of Paragon Remodeling, Booming is being successful by giving back. Ahmed started purchasing things like drywall and 2x4s with his American Express OPEN Gold Card, eventually netting him almost half a million Membership Rewards® points. He then turned those points into more building supplies. Which he donated to help build a new home for the 14-member Jackson family. Get your business Booming at open.com.

AHMED MADY
PARAGON REMODELING
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MEMBER SINCE 05

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peared as Blik wall decals since 2007 and Griffin iPhone accessories since late last year. With two stand-alone retail stores in Chicago already up and running, Threadless is working on plans to expand into brick-and-mortar retail chains and looking into more collaborations. “We’re going to push the limits of what we do,” Ryan says. “If we can find products that our artists are excited to design for and consumers are excited about, then we’re sure revenue will follow.” —*Sommer Saadi*

***The bottom line** PC maker Dell and flip-flop maker Havaianas have teamed up with Threadless because it knows how to use customer designs.*

Beverages

For India’s Consumers, Pepsi Is The Real Thing

▶ It entered the market just as Indians were engaging with the West

▶ ‘Pepsi’ is “a catch-all for anything ... bottled, fizzy, and from abroad”



Pepsi had the Indian market to itself for three years during Coke’s absence

Coca-Cola India offered to buy Rajesh Yadav a refrigerator for his New Delhi store if he would sell only the company’s drinks. He kept his part of the bargain, and lines of Coke and Diet Coke cans glisten behind the fridge’s glass front. A red-and-white banner, featuring Bollywood film star Aishwarya Rai chugging a bottle of the cola, adorns his storefront. Yet Yadav doesn’t mention his partner when he describes his shop. “I sell Pepsi and cigarettes,” said Yadav in Hindi, elongating the first syllable to pronounce the word “Pay-psee.”

Yadav isn’t reneging on his deal with Coke. Pepsi became a common synonym for cola in India’s most widely spoken language after having the market to itself in the early 1990s. **PepsiCo**’s linguistic advantage translates into higher sales for its namesake cola. Atlanta-based Coke has larger total beverage sales in India because it owns a host of non-cola drink brands there. Yet the 4.5 percent share of India’s beverage market held by Pepsi’s cola market share eclipses the 2.6 percent share of Coke’s flagship drink, says consultant Euromonitor. That’s a notable exception to much of the rest of the world, where Coke’s cola roundly beats its rival.

History explains part of the imbalance. Coke had a small presence in India before pulling out in 1977 after new government regulations would have forced it to partner with an Indian company and share the drink’s secret formula. In 1988, PepsiCo formed a joint venture with two Indian companies and introduced products under the Lehar brand. (Lehar Pepsi was introduced in 1990.) Coke re-entered the market in 1993, after Indian regulations were changed to allow foreign brands to operate without Indian partners.

Coke’s time out of India cost it dearly. “Pepsi got here sooner, and got to India just as it was starting to engage with the West and with Western products,” said Lalita Desai, a linguist at Jadavpur University who studies how English words enter Indian languages. “And with no real international competition, ‘Pepsi’ became this catch-all for anything that was bottled, fizzy, and from abroad.”

In much of the Hindi-speaking belt of northern India, home to three of the nation’s five most populous states, children begging at street corners will point to bottled juices and plead for “Pepsi.” Mahipal Singh, a 42-year-old truck driver who plies a route between New Delhi and Bihar, calls his rest stops “Pepsi-wepsi” breaks, regardless of what he is drinking. “Saying ‘Pepsi’ connotes getting a soft drink,” said Kiran Bhushi, an anthropologist at Indira Gandhi National Open University who researches consumption patterns of India’s middle class and who has consulted for both companies. “How exactly does someone like Coke dislodge this idea from a consumer’s brain?”

Coke aims to accomplish the feat by broadening its stable of products to take advantage of the growth of the

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Windy City budget blues page 36 ▶

entire beverage category in fast-growing India. When it returned to the country in 1993, Coke acquired three local brands: Thums Up cola, a lemon drink called Limca, and an orange drink known as Gold Spot. It has since added more drinks to its portfolio. Today, Coke's top three products in India by sales volume are Kinley bottled water, Thums Up, and Sprite, according to Euromonitor. The Coca-Cola brand, which fuels the company's market share growth in much of the rest of the world, ranks No. 5 among its Indian products. "Pepsi is bigger than Coke as a brand [in India], but Coke as a company has very smartly introduced other brands that have done very well," said Harish Bijoor, who runs a brand strategy consulting firm in Bangalore.

Atul Singh, Coke's president for India and South West Asia, says the blanket approach is a key part of the company's strategy. "We want every part of our portfolio to grow, so that any consumer, on any occasion, anywhere in India, makes a choice to drink a Coca-Cola product," he said. That approach to beverages is in sync with Indians' overwhelming preference for noncarbonated drinks. About 90 percent of India's beverage market is composed of tea, milk, and coffee-based drinks, with bottled soft drinks at less than 5 percent, according to Bijoor. Coke has introduced tea- and milk-based drinks, and is also making headway in sodas. Sales by volume in India surged 31 percent in 2009, Coca-Cola Chief Executive Officer Muhtar Kent said in February. And Indian sales of Coca-Cola, Diet Coke, and Coke Zero grew 25 percent last year, according to the company's annual report. Coke last year turned a profit in India for the first time since re-entering the country in 1993, according to Kamlesh Sharma, a New Delhi-based spokesman.

Meanwhile, PepsiCo Chief Executive Officer Indra Nooyi, who was born in India, says she will invest "aggressively" in emerging markets including the subcontinent. Retail sales of the company's products in India, including Frito-Lay potato chips, Quaker Oats, and fruit juices such as Tropicana, totaled $1.5 billion last year. "The Pepsi brand becoming the default name for the cola category is certainly a big positive," said company spokesman Sandeep Arora. "It can also be a double-edged sword if the marketer is not able to differentiate the brand from the rest of the category."

Perhaps that's why Coke seems to be playing the local linguistics game as well. Coca-Cola has run an advertising campaign called "Thanda Matlab Coca-Cola," which translates to "Cold Means Coke." North Indians speaking in Hindi regularly use "thanda," the word for cold, as a noun when offering someone a drink. "It was definitely a good idea," said Bhushi, the anthropologist. "If Pepsi means cola, then emphasizing that a 'thanda' means Coke is perhaps the best way to gain control of the vocabulary." —*Mehul Srivastava*

The bottom line *In much of India, the Pepsi brand has become synonymous with cold beverages. Coke uses a portfolio of drinks to counter that advantage.*

Luxury Goods

Kids' Clothes Get The Designer Treatment

▶ Straight from the runway: high-end apparel for the toddler set

▶ "If the dog is wearing Gucci, the kids aren't wearing Gap"

When it comes to dressing her three children, no label is out of reach for Loretta Lazar, a full-time mother in Paris. Sophia, 10, Noah, 2, and newborn Katarina have a wardrobe full of designer gear, says Lazar. "They don't wear Gucci or Dior every day," she says. "But I want my kids to look nice."

Gucci, the Italian brand owned by Paris-based **PPR**, and **Burberry Group**, Britain's largest luxury retailer, are targeting status-conscious parents with $340 fur-lined suede infant boots, a $375 cashmere baby outfit, and a girl's double-breasted gabardine trench coat retailing for $750.

Children's wear accounted for 5 percent of Burberry's £1.28 billion ($1.99 billion) in sales last year and may double to 10 percent "over time" as the company adds to its eight standalone children's stores, says Chief Executive Officer Angela Ahrendts. "There is excellent potential for children's wear across retail and wholesale channels, including e-commerce where sales are particularly strong."

Sales of children's designer coats and jackets climbed 13 percent, to $3.69 billion, from 2007 to 2009, according to researcher Euromonitor International. That compares with a 10 percent sales decline overall in the $195 billion luxury goods market in the same period as some consumers curbed spending during the global recession, according to consultant Bain & Co.

Worldwide sales of luxury goods are set to grow 10 percent this year, HSBC analysts Antoine Belge and Erwan Rambourg estimate. Sales of high-end children's wear should outdo that pace: Euromonitor estimates that sales of children's designer coats and jackets may grow 12 percent, to $4.13 billion this year. That's more than three times as fast as the expected sales of men's and women's luxury outerwear this year. And by 2015 the kids' high-end coat and jacket market may swell to $8.6 billion, Euromonitor predicts. 27

Part of the appeal of buying luxe for the little ones is price, according to Lazar. **Christian Dior**'s children's wear "isn't the same price as adult Dior," Lazar says. "You can get an outfit for 200 euros, whereas for adults you can barely get a T-shirt" for that amount.

Gucci will introduce clothes, small leather goods, footwear, jewelry, sunglasses, and blankets for kids under 8 for the 2011 spring selling season. "We are increasingly convinced that our brand has the reputation, authority, and the adaptability to be suc-



British retailer Burberry will add to its eight children's stores

cessful in a variety of areas," Gucci CEO Patrizio di Marco says. The collection, made in Italy, goes on sale in November.

Celebrity culture and status-seeking are driving the growth, according to Fflur Roberts, Euromonitor's luxury goods research manager. Suri Cruise, the 4-year-old daughter of actors Tom Cruise and Katie Holmes, has been photographed wearing a Burberry fur-trimmed parka and beige velveteen coat lined with the brand's signature plaid. "Lots of children will follow Paris Hilton or Victoria Beckham and want to have their clothes or be like them," Roberts says. Sarah Peters, senior retail analyst at Verdict Research, says there's also a bit of parental narcissism at work: "Parents increasingly see their children as a reflection of themselves, so they want to make sure they look good and are in the latest things."

Babies aren't the only beneficiaries of this trend. Pets are also getting a designer makeover as people without children look for a substitute to spoil and another way of showing off their status, according to Euromonitor's Roberts. That has fueled a big jump in spending on designer pet clothing and accessories. Sales of high-end pet goods such as logoed leashes, so-called doggie bags for carrying pooches, vests, and blankets almost doubled, to $1.73 billion, from 2004 to 2008, Euromonitor estimates. After stagnating last year, spending on the category may rise 4.3 percent, to $1.8 billion, in 2010 and surge to $9.14 billion by 2014, the researcher predicts. "Their owners won't feel so bad about it because it's not for them," Roberts says. "The guilt aspect is taken away if it's for their children or pets."

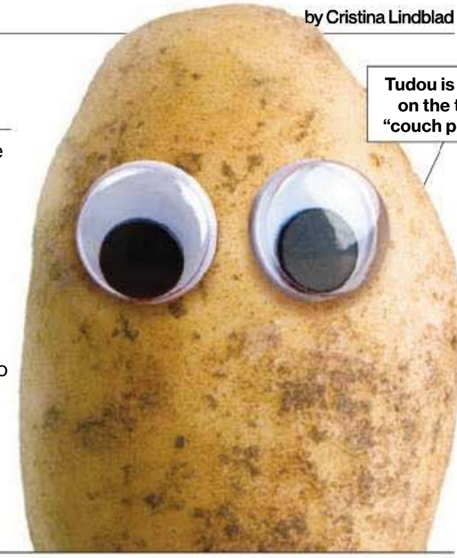
Of course, all that concern about Fido's fashion sense comes at a cost. A Louis Vuitton monogrammed canvas "Baxter" dog carrier costs $1,365. Gucci's dog bag costs $1,430, while a medium dog leash by the Italian fashion house costs $450.

Parisian mom Lazar, 40, doesn't have a dog. Some of her American and Asian friends do, however. "Let's put it this way," she explains. "If the dog is wearing Gucci, the kids aren't wearing Gap." B —*Andrew Roberts*

The bottom line *Designer clothing for children is a fast-growing segment, thanks to brand-conscious parents eager to express their own sense of style.*

Briefs

by Cristina Lindblad



Tudou is a play on the term "couch potato"

Tudou
China video-sharing will go public

Gary Wang, the founder and chief executive officer at Shanghai-based Tudou.com, China's second-largest online video site, says the company has plans for an initial public offering soon to better compete against rival Youku.com in the world's biggest Internet market. China has 420 million Internet users, and about 75 percent of them watch videos online. Last year, Youku had about 18 percent of China's online-video market, and Tudou roughly 13 percent, according to analysts. Tudou, whose name is a playful reference to couch potatoes, will seek a listing on a stock exchange outside China in order to give its Western backers "the exit they need," Wang says.

Japan Bank for Intl. Cooperation
California rail project may get a hand

State-owned Japan Bank for International Cooperation is offering loans to support California's $40 billion high-speed rail project. The 432-mile Los Angeles-to-San Francisco link, due to open in 2020, will transport passengers between the two cities in less than three hours. Japan is offering the loan (of undisclosed size) to give Japanese companies, including East Japan Railway, an edge on European and Asian rivals in bidding for contracts for the project.



Best Buy
Overseas sales are driving profits

61%

The world's largest consumer-electronics retailer reported a 61 percent profit gain for the second quarter as purchases overseas climbed 6 percent. Best Buy reported earnings of $254 million, compared with $158 million for the same period last year. Shoppers abroad account for about a quarter of the retailer's revenues.

Archer Daniels Midland
A more palatable name for corn syrup

The Corn Refiners Assn. has petitioned the U.S. Food and Drug Administration to allow makers of high fructose corn syrup to call their product "corn sugar." In a statement, the trade group—which represents Archer Daniels Midland and Cargill, among others—said "independent research" shows current labeling confuses U.S. consumers. Despite an industry-backed ad campaign designed to dispel concerns about the health effects of the sweetener, consumption of corn syrup has fallen to a 20-year low. Scientists have speculated that there is a connection between corn syrup and obesity, but there's been no conclusive research on the topic.

Wal-Mart Stores
Up against farmers as well as unions

An alliance of farmers, ranchers, and labor is criticizing Wal-Mart, the world's largest retailer, for allegedly using its market power to hold down agriculture prices. The United Food and Commercial Workers International Union, the National Farmers Union, and others want the Obama Administration to broaden its inquiry into anticompetitive practices in agriculture to include Wal-Mart. Their complaints will get a public airing at a Justice Dept. and Agriculture Dept. workshop set for December.



On the Move

VW's Jonathan Browning named CEO of U.S. operations • Verizon CFO John Killian to retire at the close of 2010 • Goldman Sachs' Eileen Rominger, chief investment officer, is stepping down at year's end

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MEETING FACE-TO-FACE DIDN'T JUST EXPAND MY BUSINESS.

IT HELPED MY NEW PARTNER EXPAND HERS.

-Judi Henderson-Townsend, Mannequin Madness





Judi Henderson-Townsend has an eccentric job: she sells and rents mannequins. So when she found someone who did the same thing halfway around the world, Judi's eyes lit up. But before she could make a total stranger her partner, Judi had to meet her – face-to-face.

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BILL CLARK/ROLL CALL/GETTY IMAGES

Jim DeMint's Path to Power

▶ Some Republicans are bristling over his successful backing of Tea Party candidates

▶ He says his goal for the Senate is nothing short of "complete gridlock"

The phones wouldn't stop ringing at the Capitol Hill office of South Carolina Senator Jim DeMint on Sept. 15, the day after Tea Party-backed Christine O'Donnell, one of his protégés, had unexpectedly defeated popular Delaware Congressman Mike Castle for the Republican Senate nomination. DeMint was besieged with requests for television appearances and interviews.

While Sarah Palin gets most of the attention for helping numerous unlikely candidates win Republican primaries, DeMint, 59, is an even bigger force. The first-term senator and former marketing executive has vaulted from backbencher to conservative kingmaker. He's a recruiter, fundraiser, and agenda-setter, racking up electoral victories for Tea Party underdogs in Senate races across the country.

Senators up for reelection in 2012 will want to avoid crossing DeMint and the Tea Party grassroots

In the process, he's rapidly building a power base in the Senate that will exert huge influence on the national agenda next year. He's also angering some of his Republican colleagues, including Karl Rove, former President George W. Bush's political strategist. They argue that O'Donnell and other "DeMint disciples," as former Senate Republican leader Trent Lott calls them, are so conservative and inexperienced that they aren't likely to win in the general election. If that happens, they say, he will deny the GOP the

10 seats it needs to take control of the Senate. "We've probably just written off Delaware, and we're shocked and disappointed about it," says Ron Bonjean, a former top Republican Hill aide.

DeMint doesn't care. He tells *Bloomberg Businessweek* his goal for the Senate is "complete gridlock" and that he wants to stop programs that violate his anti-Big Government ideology. "What happens in the Senate is the Republicans sink to the lowest common denominator," he says, taking a quick break between TV appearances. "People want an alternative to some kind of watered-down Republican philosophy."

DeMint formed a political action committee, the Senate Conservatives Fund, in late 2008 with the goal of backing candidates that the national party was likely to ignore. The fund ranked Senate Republicans on how conservative they were. DeMint was the only one to score 100 percent; Kentucky's Mitch McConnell, the Senate Republican leader, came in at 79.

His group first took aim at Senator Arlen Specter, a Pennsylvania Republican who often voted with Democrats. DeMint endorsed Specter's primary opponent, Pat Toomey, a former congressman known as a tax-cutter and fiscal hawk. Specter left the Republican Party a few days later to run as a Democrat, and lost.

That victory emboldened DeMint to take on more of the Republican Establishment, starting with Florida Governor Charlie Crist, a moderate seeking a U.S. Senate seat. DeMint raised hundreds of thousands of dollars to promote the former state speaker, Marco Rubio. In April, as polls showed Rubio running away with the race, Crist left the party. "Republicans would not have the wind at our backs if we stood up for candidates like Arlen Specter and Charlie Crist," DeMint says.

Since then, DeMint's money and manpower have upset Senate Republican primaries in Colorado, Utah, Kentucky, and Delaware. Of the 13 candidates he's endorsed, only three have lost. Last year he raised $1.3 million. This year his PAC has pulled in more than $4 million, says spokesman Matt Hoskins.

Even if Republicans fail to win control of the Senate, DeMint's importance is rising. "In the Senate, if you got a half-dozen people who follow you, you have a major movement going," says Rutgers political science professor Ross K. Baker. "The big threat is to Mitch McConnell." DeMint says he doesn't want to challenge McConnell, or run for a leadership position. Still, says Baker, he is creating a "rival power center" that will move the party to the right. The candidates he supported will owe DeMint a "certain obligation of support," Baker says. Senators up for reelection in 2012 will not want to cross DeMint and the Tea Party by compromising with President Barack Obama and congressional Democrats, fearing that would invite a primary challenge.

DeMint's opposition is sure to set back one of Obama's priorities for the second half of his term: overhauling immigration laws. DeMint was a strident opponent of Bush's 2007 immigration plan, calling it "amnesty" for helping some illegal immigrants attain lawful status.

Tax policy is another area where DeMint could thwart the White House. In his book *Saving Freedom: We Can Stop America's Slide into Socialism*, published last July, DeMint advocates flat income-tax rates of 10 percent and 25 percent.



Christine O'Donnell after her Delaware victory

He would kill the corporate income tax and substitute it with an 8.5 percent consumption tax. He also talks of reviving a failed Bush plan to partially privatize Social Security—which he considers "socialistic." The Federal Reserve is another area where DeMint and his troops are likely to take aim. He has repeatedly pushed for greater scrutiny of the central bank.

The first priority of the new conservative lawmakers, says DeMint, will be to stop new spending and repeal Obama's health-care legislation. "When we have a few who vote with the Obama agenda, it defines the whole Republican Party," DeMint says. "Win or lose, we are fighting for the right cause."

—Lisa Lerer, with James Rowley, Patrick O'Connor, and Jonathan D. Salant

The bottom line *Senator Jim DeMint's money and message are helping Tea Party candidates win primaries as he builds a Senate power base.*

Consumer Protection

Appointing a Firebrand Without a Senate Fight



▸ **Obama wants to put Elizabeth Warren at the Treasury Dept.**

▸ **Some of her backers would prefer to "dare the opposition to vote no"**

The Obama Administration is about to find out what happens when you offer a short leash to a voluble watchdog. Rather than nominate the outspoken Elizabeth Warren to head the newly created Consumer Financial Protection Bureau, the White House plans to install the Harvard law professor at the Treasury Dept., with the interim assignment of overseeing the establishment of the agency. Obama aides hope this maneuver will avoid a confirmation battle with Senate Republicans while not alienating Warren's backers in labor and consumer protection circles.

Warren, who declined to comment, is expected to take the compromise job. If so, she would report both to President Barack Obama and to Treasury Secretary Timothy Geithner, with whom she has clashed in her role as head of the Congressional Oversight Panel monitoring the $700 billion bank bailout. An announcement could come by Sept. 17, Administration aides say.

The prospect of Warren being supervised by the more circumspect Geithner—as opposed to her heading her own agency—is precisely what makes the idea more palatable to the banking industry. The bureau would be "starting off with a very strong hand of oversight," says Wayne Abernathy, an executive vice-president at the American Bankers Assn. "That would be a very good thing."

Congress has instructed that the consumer bureau be fully launched within 18 months. Its director will have a five-year term and will be removable only for cause, such as malfeasance.

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Taxes

Stacking Up the Bush Tax Cuts

The Bush tax cuts expire on Dec. 31. President Barack Obama and most Democrats want to renew all the cuts except those affecting the highest incomes, at a 10-year cost of about $3.3 trillion. Republicans want to extend them for all income levels, adding almost $1 trillion. Former Fed Chairman Alan Greenspan says the U.S. can't afford either approach. —*Ryan J. Donmoyer, Andy Cinko, Max Berley, and Christine Spolar*

The 10-year loss in revenue that the government would incur if the tax cut were enacted

Percentage of the **$4.34 trillion** worth of expiring tax cuts

Indicates that tax-cut proposal requires offsetting spending cuts or tax increases elsewhere to pay for the reduction.

Middle-Income Rates

Continue Bush-era tax rates of 10%, 15%, 25% and 28%. About 97% of taxpayers pay at those rates.

10-Year Cost
$1,180.0bn

Supporters
Republicans
Democrats
Barack Obama

Opponents
Alan Greenspan
George Voinovich

Must Be Paid For
NO

Upper-Income Rates

Sustain Bush-era rates on income above $200,000 for individuals and $250,000 for joint filers. If allowed to expire, as Obama proposes, top rates will rise to 36% and 39.6% from 33% and 35%. Sustains repeal of limits on deductions and personal exemptions. This affects about 3% of taxpayers.

10-Year Cost
$700bn

Supporters
Republicans
Some Democrats
Mitch McConnell
John Boehner

Opponents
Most Democrats
Barack Obama
Alan Greenspan
Warren Buffett
George Voinovich

Must Be Paid For
YES

Child Tax Credit

$1,000 tax credit per child under 17.

10-Year Cost
$359.5bn

Supporters
Republicans
Democrats
Barack Obama

Opponents
None

Must Be Paid For
NO

Small Business Expensing

Current law allows small businesses to write off up to $125,000 of equipment in the year of purchase rather than depreciating that expense over time. The 2008 stimulus legislation temporarily increased the amount to $250,000. If it expires, the write off drops to $25,000.

10-Year Cost
$25.7bn

Supporters
Republicans
Democrats
Barack Obama

Opponents
None

Must Be Paid For
NO

Alternative Minimum Tax*

The AMT, intended to ensure the richest Americans didn't avoid taxation, has increasingly ensnared middle-income families. More than 30 million households could face higher taxes if Congress doesn't limit its impact.

10-Year Cost
$583.6bn

Supporters
Republicans
Democrats
Barack Obama

Opponents
None

Must Be Paid For
NO

Marriage Penalty Relief

Tax break for joint, married filers.

10-Year Cost
$359.6bn

Supporters
Republicans
Democrats
Barack Obama

Opponents
None

Must Be Paid For
NO

Investment Income

Dividends and capital gains rates of 15% expire on Dec. 31. Republicans want to maintain those rates. If they expire, cap gains rates rise to 20% and dividends are taxed at rates as high as 39.6%.

10-Year Cost
$314.6bn

Supporters
Republicans
Some Democrats

Opponents
Democrats
Barack Obama

Must Be Paid For
YES

OBAMA'S PROPOSAL

Investment Income*

Obama wants to raise capital gains and dividends rates to 20% for upper-income taxpayers and keep the current levels of 0% to 15% for middle-income earners.

10-Year Cost
$238.3bn

Supporters
Democrats
Barack Obama

Opponents
Republicans
Some Democrats

Must Be Paid For
YES

Sustain 0% Estate Tax Rate

Legislation gradually reduced the estate tax over 10 years until it was phased out for 2010. In 2011 the tax will return with a top 55% rate on estates of more than $1 million per individual, $2 million per couple.

10-Year Cost
$666.1bn

Supporters
Republicans
Some Democrats

Opponents
Most Democrats
Warren Buffett

Must Be Paid For
YES

OBAMA'S PROPOSAL

Estate Tax

Obama wants a 45% top rate—the same rate as for 2009—on estates exceeding $3.5 million per individual, $7 million per couple.

10-Year Cost
$253.3bn

Supporters
Some Democrats
Barack Obama

Opponents
Some Republicans

Must Be Paid For
YES

* Cost figure assumes expiration of all Bush tax cuts. If all Bush tax cuts are renewed, the AMT costs $658 billion over 10 years.

DATA: BLOOMBERG

Verizon wants to power up your blender
page 41 ▶



The agency's funding, expected to be $400 million a year or more, is based on the budget of the Federal Reserve, not a special congressional appropriation. Its work won't be subject to approval by the Administration. "The choice of a head will be one of the most consequential regulatory decisions that the President makes," says Michael Greenstone, director of the Hamilton Project at the Brookings Institute and a former chief economist with the White House Council of Economic Advisers.

If she accepts the interim appointment, Warren would oversee a lot of nuts-and-bolts administration. Offices and phone lines have to be set up, thousands of employees hired. That's all before the agency gets to its main mission: writing and enforcing regulations for financial companies.

Given Warren's penchant for passionate critiques of the industry, she could be counted on to try to use the Treasury job to hold hearings, go on television, and generally keep the spotlight on credit card and mortgage abuses. Still, some of her fans are spoiling for a fight. Obama, says Lynn Turner, a former chief accountant at the Securities and Exchange Commission, "should do what the Republicans would have done, nominate her for the head of the consumer bureau and dare the opposition to vote no."—*Robert Schmidt and Hans Nichols*

***The bottom line** The White House has a plan for installing consumer advocate Elizabeth Warren in an interim position at Treasury.*

Jobs

Obama's Blue-Collar Crusader

▶ Ron Bloom wants to reverse the 50-year trend of exporting jobs

▶ "While he's a tried-and-true union guy, he's realistic"

As a boy, Ron Bloom spent summers at Habonim camps, Jewish youth programs modeled on Israel's kibbutzes that stressed the value of manual labor and social justice. As a teenager, he boycotted green grapes in support of César Chávez, the farmworkers' charismatic union leader. He went on to Harvard Business School and Wall Street. And then he helped industrialist Wilbur Ross save **U.S. Steel** and President Barack Obama bail out **General Motors**. Now he wants to rescue U.S. manufacturing.

For many of his 55 years, Bloom seems to have been in training for his job as Obama's senior counselor for manufacturing. He's the guru behind Obama's drive to get the U.S. to create more factory jobs, a position he began on Labor Day 2009. He's been traversing the country ever since, trying to get executives in all manner of businesses to rethink a 50-year trend of sending work abroad.

Good luck with that, skeptics say. Manufacturing accounts for just 11 percent of U.S. gross domestic product, down from a peak of 28 percent in 1953. Moreover, Republicans are poised to gain more power in congressional midterm elections this fall as polls show the public souring on the Administration's efforts to revive a long-staggering economy.

"I'm trying to find some common ground, and I'm trying to find it in a time of enormous uncertainty," the soft-spoken Bloom says in an interview in his Treasury Dept. office, where he has a collection of Mr. Potato Head dolls and Spider-Man paraphernalia.

TRW Automotive Chief Executive Officer John C. Plant, who recently invested $100 million on a factory making fuel-saving technology, is among the two dozen business leaders he has met with. Over dinner in Detroit, Bloom said he wanted to see more such investments. Plant says he told Bloom that may not happen because U.S. business suffers from a "crisis of confidence" due to a lack of clear direction in tax, energy, and other policies.

As an adviser to the United Steelworkers for 13 years, and before that as a manufacturing specialist at **Lazard** and his own boutique investment firm, Bloom participated in more than 100 bankruptcies and restructurings, trying to balance the realities of business with the need for jobs. "While he's a tried-and-true union guy, he's realistic," says Ross, who first worked with Bloom during the bankruptcy of U.S. Steel.



Ron Bloom in in his office at the Treasury building

Behind him, vintage photos from his personal collection

Even when he worked at Lazard, Bloom embraced "worker capitalism," says investment banker Steven Rattner, who recruited Bloom to be his deputy as Obama's auto bailout czar. Bloom succeeded Rattner in that job in July 2009. "Most people took their Harvard MBAs and went off to trade derivatives, and he took his and went off to try to save manufacturing and save workers," Rattner says.
—*Jeff Green*

***The bottom line** Corporate executives are skeptical of Obama's manufacturing adviser Ron Bloom's quest to revive the "Made in America" label.*

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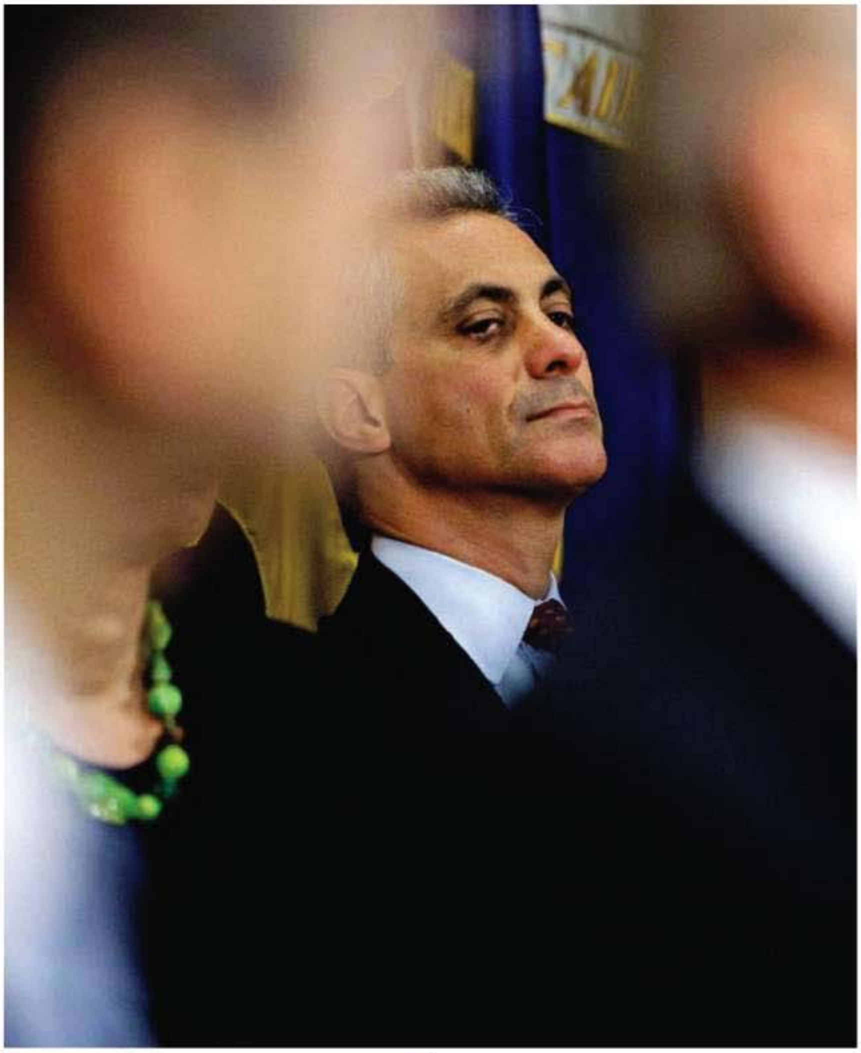
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City Politics

The Bad News Awaiting Chicago's Next Mayor

▶ Political gridlock and a budget shortfall could make the job tough

▶ "They're in line for a downgrade ... the market is telling you something"

As Rahm Emanuel explores a mayoral bid in his hometown of Chicago, he faces two unpleasant outcomes should he decide to run: He could lose. Or he could win. A loss would diminish the reputation of the savvy White House Chief of Staff and brawling politician–a more petite version of Lyndon B. Johnson. A win would mean inheriting a gargantuan fiscal mess, a cantankerous city council, and a 10.5 percent metropolitan area jobless rate.

After Richard M. Daley's Sept. 7 announcement that he would not seek a seventh term as mayor of America's third-largest city, a growing list of candidates is exploring bids for the office. They include popular Cook County Sheriff Tom Dart; State Senator James Meeks, minister at one of Chicago's largest congregations; former city Inspector General David Hoffman; and Democratic Representative Luis Gutierrez. Top Chicago politicians say Emanuel (above) is no shoo-in, and that Dart and Meeks may be more formidable contenders. The office has been held by the current Mayor Daley or his father, Richard J. Daley, for 43 of the past 55 years.

The current Mayor Daley's political prowess has camouflaged a host of racial, ethnic, and political schisms in the city that are likely to erupt after he leaves, as they did in 1983, seven years after his father's death. Chicago can't afford such political chaos now, given that the city faces an estimated $655 million deficit in its $3.39 billion budget for 2011. Business leaders want "someone that can keep this city connected globally, someone who is a leader, someone who is a fiscal conservative," says Jerry Roper, president of the Chicagoland Chamber of Commerce.

19%

Estimated shortfall in Chicago's $3.39 billion budget for 2011

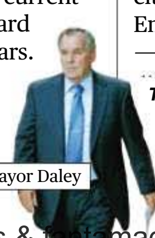
Whether Emanuel, 50, is that candidate isn't clear. "Not everyone is going to salute and line up to support him," says Dick Simpson, a political science professor at the University of Illinois at Chicago. Candidates have until Nov. 22 to file nomination papers for the Feb. 22 election, which is almost certain to be followed by a runoff contest on Apr. 5.

Chicago's next mayor will surely face a cash squeeze since Daley spent most of the $3.5 billion gained from leasing parking meters, garages, and a 7.8-mile elevated toll road. Moody's Investors Service cut Chicago's credit rating on $6.8 billion of general obligation debt, to Aa3, the fourth-highest, from Aa2, before an August bond sale. "They're a AA-rated borrower that is trading as if it was rated A," says Richard Saperstein, managing director at Hightower Advisors Treasury Partners in Chicago. "This means they're in line for a downgrade. The market is telling you something."

Daley's decision in 2008 to let a **Morgan Stanley**-led partnership run its parking meters was especially controversial. While the $1.15 billion deal brought in cash, Bloomberg News reported in August that recent financial documents show drivers will pay at least $11.6 billion in parking meter charges in the next 75 years, or 10 times what the city received for the lease. Even Rahm Emanuel can't fix that.

—John McCormick and Darrell Preston

The bottom line *As Chicago's Daley exits, the next mayor faces potential racial tensions and few options to close a budget shortfall.*



Outgoing Mayor Daley

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Charlie Rose talks to

Paul Ryan



The Republican representative from Wisconsin's bill–"Roadmap for America's Future"–proposes cutting the federal debt by partly dismantling Social Security and Medicare

Tell me about this road map and why you felt you had to write it.
We are walking off a fiscal cliff. We will have our own debt crisis, and the social safety net will shred itself. My plan says nothing changes for anybody 55 and above. So if you are in retirement, on Medicare or Social Security, or 10 years away from retiring, if we act now, we can guarantee your benefits. But if you are 54 and below, you already know these programs won't be the same.

People say the urgent problem is unemployment. The constant one is the deficit. But dealing with unemployment adds to the deficit.
I would actually argue that one of the best things to do for the economy now is to show that we're getting the debt situation fixed. That will help unlock uncertainty in the economy. It will help us take pressure off our currency and stabilize interest rates.

But are you prepared to spend money for stimulus in order to do something about unemployment?
I don't subscribe to the typical Keynesian doctrine that you need to borrow and spend money to create jobs. We borrowed and spent $1.1 trillion when you add interest costs to the stimulus, and we've lost 2.6 million jobs since that legislation passed. I would argue that the reason jobs aren't materializing is because government is producing so much uncertainty. We have a debt crisis right around the corner, plus new regulations that are causing businesses to sit on capital and not hire employees.

Stimulus doesn't work?
There are better ideas that would help create jobs, such as keeping our tax rates low, reducing spending, and showing we are serious about our debt situation. That and more regulatory certainty would help us unlock private capital.

There's regulatory certainty now that we have financial reform.
There are over 500 regulations that will come out of this new law that haven't been promulgated yet. We have a new health-care law, and many businesses don't really know what the consequences are. So the government has done a lot lately that is having a chilling effect on businesses. When I talk with businesses big and small, I get the same question every time: What is the government going to do to me next? What I really worry about is this class-warfare rhetoric we're getting from the White House and from others that is pitting people against each other, using the election-year moment to tap into the emotions of fear and envy. Those might make for good short-term politics. They make for rotten economics.

What would you do about taxes?
I give people an option. Do you want the current system with its bells and whistles, or do you want a postcard-type tax return, two rates–with none of the loopholes and deductions–10 percent on the first $100,000 for couples, 25 percent after that? Generous personal and standard deductions such that a family of four earning $39,000 would not pay tax until after that amount. For businesses, I would repeal corporate income taxes.

No itemized deductions, which the rich have been able to use better than the poor?
That's right. That is who gets these itemized deductions. It's the people in the top tax brackets that can manipulate their tax code to pay lower taxes. I would replace the corporate income tax with an 8.5 percent consumption tax. Our tax rates matter a great deal. We're pushing money and companies overseas because of our tax code.

What will happen in the midterms?
The other side has more money and a lot of muscle. And so we as Republicans should not start measuring the drapes. What I see happening not just in this election but also in 2012 is a political realignment. The only real question is, which way is it going? Right now it is very much going to the left of center. We're not playing small ball anymore. We are talking about what this country is going to be in the 21st century.

Is the Tea Party a threat to the Republican Party?
If we violate our principles in office in the next two years, then it more or less creates a third party [in 2012]–a Ross Perot kind of a phenomenon, and that will reelect this Administration.

How many Republicans have signed on to the road map?
I jumped into the pool of entitlement and economic reform hoping other people would jump in with me. So far I'm swimming around by myself. B



Watch Charlie Rose on Bloomberg TV weeknights at 8 p.m. and 10 p.m.

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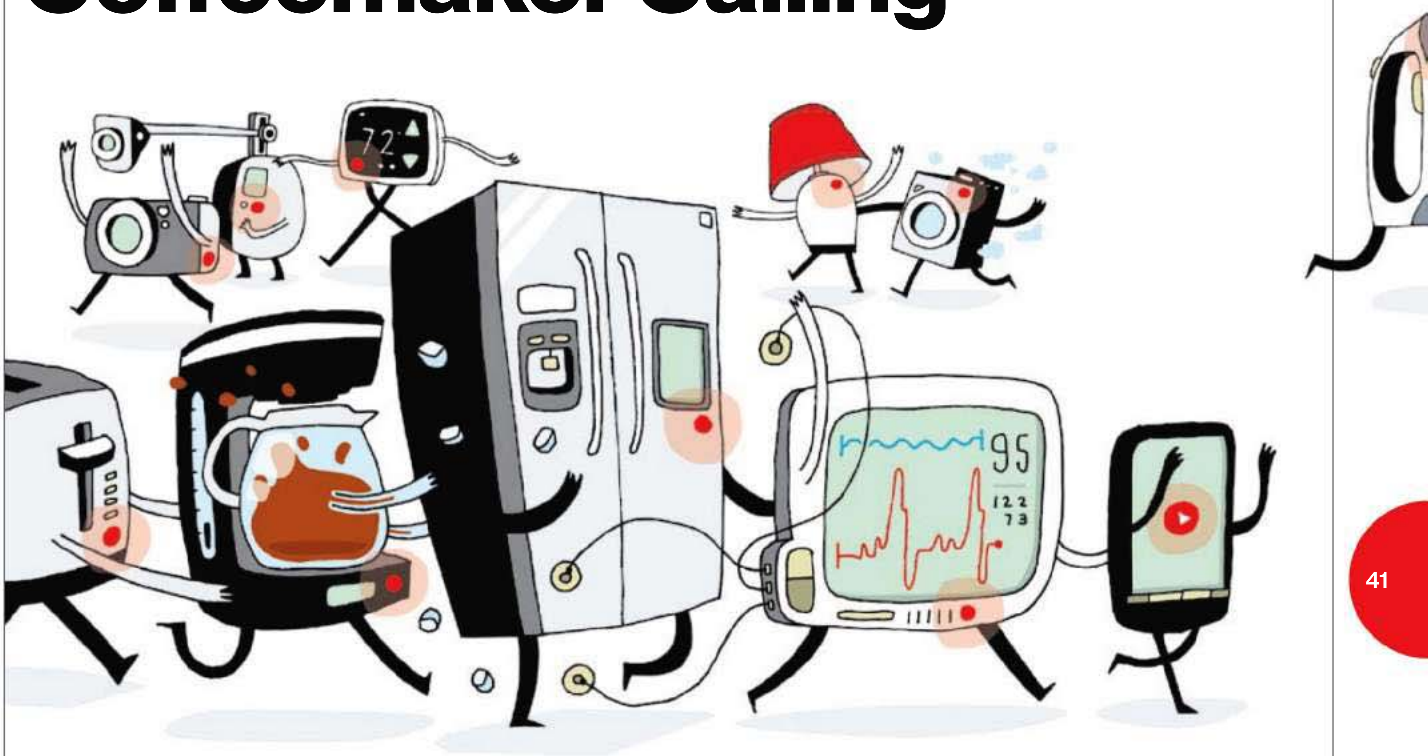
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Contents ▶ Samsung, shutterbug 42 ▶ Quid's new tool to analyze startups 43 ▶ How UPS trucks deliver efficiently 43 ▶ Consumer resistance to smart utility meters 44 ▶ Innovator: Andrew Thompson's digital drugs 45 ● Edited by Jim Aley

Technology

'Good Morning, This Is Your Coffeemaker Calling'



▶ As the mobile market slows, Verizon wants to connect other products to its 4G network

▶ "Everything that can benefit from being connected will be connected"

Each year at the Consumer Electronics Show, the industry puts on display what it hopes will be the next must-have gadgets. In January a new exhibitor will appear at the confab in Las Vegas: **Verizon Wireless**. The company plans to build a mammoth, two-story booth that will not be focused on hawking phones. Mostly, Verizon will be pushing its vision of a future full of wirelessly connected autos, refrigerators, MRI machines, and countless other devices.

Verizon's debut at CES is part of a larger campaign to get 4G into products not usually associated with digital high-speed networks. The U.S. mobile market is saturated, with 91 percent of the population already having a wireless plan. "Growth in the traditional business is slowing pretty quickly," says John Hodulik, a telecom analyst with UBS. Focusing on other kinds of products is "the best hope for the growth of the industry over the next decade."

Verizon says it has already persuaded manufacturers including **Eastman Kodak**, **LG**, **Samsung**, and **Dell** to start developing products to take advantage of 4G data speeds. Branching out from phones is also an opportunity for Verizon "to leapfrog its competitors," says Hodulik. **AT&T** remains focused on upgrading its existing 3G architecture, and the commercial launch of its 4G network is still months away, according to John T. Stankey, president of AT&T's operations.

Verizon's ultrafast fourth-generation network uses a technology standard called Long Term Evolution, or LTE. Tim Horan, a telecom analyst at Oppenheimer, estimates Verizon is spending about $3 billion to upgrade its network to 4G service, which will launch later this year. While current third-generation networks allow for average download rates of up to 1.7 megabits per second, 4G customers can expect to see average download speeds of about 10 Mbps—fast enough to download a song in about four seconds. That's faster than many home broadband connections and zippy enough to stream live television to mobile devices. "Essentially we're taking that desktop experience and allowing you to take that with you on the road," says Verizon Chief Technical Officer Tony Melone.

Networked appliances and other devices are "the best hope for the growth of the industry"

The first products capable of surfing the airwaves at such

ILLUSTRATION BY ALEX EBEN MEYER

Technology



speeds will be the obvious ones: LTE-enabled laptops will be available later this year, and smartphones will follow in 2011.

As Verizon's director of ecosystem development, Brian Higgins is responsible for getting nontraditional devices hooked up to the network. His team has built the LTE Innovation Center in Waltham, Mass. It's an 8,000-square-foot laboratory where electronics makers can test new products on a fully functional 4G network. **Alcatel-Lucent** and **Ericsson Wireless**, which make much of the hardware that underpins the 4G network, have partnered with Verizon and provide the gadget makers in Waltham with design and technical support.

Ken Wirth, the president of 4G/LTE Wireless Networks at Alcatel-Lucent, says the new, high-speed network will be well-suited for data-intensive industries such as health care. MRI machines and CT scanners will be able to beam large, high-resolution images to portable devices used by doctors or patients, for instance. Alcatel-Lucent has built several demonstration devices, including wireless glucose monitors for diabetic patients. Wirth says he expects the family car to become a 4G playground, with kids downloading video games and movies from the backseat. Even some home appliances, such as coffeemakers and refrigerators, will be connected, he says, to automatically communicate with repair technicians. Håkan Eriksson, the chief technology officer for Ericsson, says the wireless antenna will become like the electric motor—so common in cars and household appliances it will be taken for granted. "Everything that can benefit from being connected will be connected," he says.

Verizon is now replacing its Innovation Center with a bigger, 20,000-square-foot facility. The new center will house mockups of hospital rooms, kitchens, and garages to showcase LTE-ready products in realistic environments. The company hopes the Innovation Center and a $1.3 billion venture capital fund it is using to invest in some smaller companies will yield a large, growing customer base for its 4G service. "If you just build the network and wait for things to happen, you're going to be disappointed," says Higgins. It's also an early effort to pitch to a new type of customer. Persuading an appliance manufacturer to add wireless to its washing machines "is a completely different ball game than marketing a hot new handset to the residential market," says Craig Moffett, a telecom analyst at Sanford C. Bernstein. —*Amy Thomson*

The bottom line *Verizon is encouraging makers of medical devices, home appliances, and other products to build around its new 4G network.*

Consumer Electronics

Samsung: Pointing and Shooting at Apple



▶ Despite a slow market, the company is pushing into cameras

▶ Its photo business "is still more focused on hardware, not software"

Samsung Electronics has chosen an unusual time to get into the camera business. The global market for digital still cameras shrank 7.5 percent last year, according to IDC, which predicts the market will grow at 5.4 percent or less for the next four years. "The growth is almost nothing," says Soo-Kyoum Kim, an IDC analyst in Seoul. A big reason for that is the rise of camera-equipped smartphones. Samsung's position: Sometimes only a real picture will do. "When it comes to serious occasions, people pick up a camera," says SangJin Park, president of Samsung's digital imaging unit.

The company is counting on cameras to help it compete with **Apple** and reduce its reliance on semiconductors. Apple doesn't make cameras and that, argues Park, has created an opening for Samsung. Just as the popularity of the iPhone helped build excitement about the iPad, Park says Samsung will use digital cameras to build brand awareness for the company's TVs, smartphones, and other products. On Sept. 14 in Hong Kong, Samsung launched a line of professional-grade cameras meant to compete with **Nikon** and **Canon**.

Samsung has been trying to steal market share from Apple on several fronts. Its new smartphone, the Galaxy S, introduced in the U.S. in August, is winning raves worldwide. The company also has high hopes that the tablet PC it introduced this month will attract customers who otherwise would buy the iPad. Samsung says it's considering putting **Google**'s Android operating system into its TVs. That would allow its sets to compete with the recently revamped Apple TV, which viewers can use to watch online content on their television sets.

Ultimately, Samsung needs to rely less on sales of memory chips. Some 58 percent of its profits this year will come from semiconductors, says Han Seung-hoon, an analyst in Seoul with Korea Investment & Securities. It's a volatile business: Last year memory chip sales accounted for just 34 percent of earnings because of the slump in PC sales. "If you look at most of the global tech companies, their profit is much more stable," Han says.

The company wants to remain true to its engineering roots by developing advanced technology, says Byungdeok Nam, a Samsung research and development vice-president. He worked on the NX100, a new multi-lens camera that, unlike conventional single-lens reflex cameras, does away with the mirror that directs light through the lens and to the photographer. That helped Samsung shrink

OPPOSITE PAGE FROM TOP: REUTERS; ILLUSTRATION BY KATE FRANCIS

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The Nigerian oil minister's delicate dance page 49 ▶



the camera to just 25.5 millimeters in width, compared with 45mm for other manufacturers' cameras.

Samsung is also trying to make its cameras cool. Kim InShik, a goateed 37-year-old designer dressed in jeans and a Batman T-shirt, has designed models that can tilt at a 7-degree angle while sitting on a tabletop, eliminating the need for a tripod when taking self-portraits. He and other designers have also pushed the boundaries of the production process with a technique (originally used in car assembly plants) that uses water at a high pressure to shape steel and create a smoother, more rounded look for Samsung's compact cameras. "We wanted to come out with a product that gave the feeling of being carved with human hands," says Kim.

Samsung's photo business "is still more focused on hardware, not software," says James Song, an analyst with Daewoo Securities. Software is important: It's what makes all of Apple's iGadgets work seamlessly together. Samsung's biggest strength is vertical integration–it makes the chips, displays, and batteries for all of its hardware. If Samsung is going to be like Apple, Song says, it needs to be just as good at creating software.

Camera boss Park says that's coming. He talks of enabling photographers to connect wirelessly to social networking sites and use Samsung apps to edit photos on their tablets, PCs, phones, and TVs. Says Park: "That's our next homework." —*Bruce Einhorn*

The bottom line *Samsung is launching a line of cameras even as photo-enabled smartphones eat into industry sales worldwide.*

Startups

A Spyglass Trained on Silicon Valley

▶ **Quid sheds light on the opaque world of technology startups**

▶ **Microsoft uses the data to stay "aware of the latest trends"**

Finding high-quality information about a public company such as IBM or General Electric is simple. Sorting out which startups are working on synthetic biology is far trickier. "It's in private companies where so much of the world's technology is being developed," says Bob Goodson, a 30-year-old entrepreneur in San Francisco. "To date, no

➔

Logistics

Squeezing More Green Out of Brown

UPS managers are efficiency freaks. The company, for example, tells drivers to avoid left turns because they take longer than rights. Starting a few years ago it began rigging trucks with sensors that give readings on everything from vehicle location to brake pad wear. UPS says the system has reduced fuel use by 25 gallons per truck over the course of a year and allowed it to replace parts before they break. Nearly half its 55,000-vehicle U.S. fleet will be outfitted with telematics by yearend, yielding millions of dollars in savings. —*Mary Jane Credeur*

Special Delivery: Where the Truck Sensors Are

1. Headlights: Checks if bulbs are working.
2. Engine: Provides readings on oil levels and fuel use and monitors how hard the engine is working.
3. Brakes: Measures how often and hard the breaks are applied.
4. Seat belt: Checks if it's buckled.
5. Transmission: Measures fluid levels and gear changes.
6. Data reader: Collects over 200 streams of information, uploaded daily to UPS computers.





Cost-Saving Tips

Drivers are told to carry the ignition key on the pinkie finger of their nondominant hand so they don't lose time rummaging through their pockets.

Technology

Quid can pinpoint where innovation is happening, what trends are emerging, and where the funding is

one has delved into what these companies are doing."

On Sept. 14, Goodson and co-founder Sean Gourley launched **Quid** to address that need. (The business was spun off from **YouNoodle**. *Bloomberg Businessweek* has collaborated with YouNoodle on several research projects.) Investor Peter Thiel says Quid has the potential to become the go-to source for high-quality information on technology startups. Over the last two years, Quid stealthily researched thousands of private companies, building a database that includes legal filings, financing information, hiring decisions, and consumer sentiment about them as expressed on sites such as Twitter. While other research firms claim to have comprehensive data on private companies, Goodson says Quid is distinct because it analyzes the raw numbers, helping pinpoint where innovation is happening, what trends are emerging, and where the funding is. Quid's software, for instance, can infer how fast a startup is growing based on openings posted on job sites.

Goodson says Quid's information will be valuable to venture capitalists, governments, and large technology companies, all of which need to keep tabs on trends. Three of the world's top technology companies started using Quid even before its public launch, according to Goodson. He'll name only **Microsoft**, which tracks the social gaming industry with Quid. "We use Quid data and analytics to keep 2,000 managers aware of the latest trends and facts from the world of emerging business," says Cliff Reeves, director of the emerging business team at Microsoft. The U.K. government also subscribes to Quid's analytics to track British technology companies.

Thiel, one of the founders of **PayPal** and the first outside investor in **Facebook**, has invested about $2 million in Quid and YouNoodle. He says Quid's products will be essential to others in his field. "Venture capital and a lot of those things that are involved around developing new technologies are themselves quite low-tech," says Thiel, 42. "One of the things that would be revolutionary about Quid is an attempt to bring high tech to the industry that tries to develop technology itself." —*Ari Levy*

The bottom line *Governments, venture capitalists, and companies use Quid's data and analytics to keep tabs on emerging technology trends.*



Goodson at Quid's offices in San Francisco

Green Tech

Smart Meters May Not Be So Clever



▶ A consumer backlash is slowing rollouts of new electric meters

▶ "We, as an industry, need to continue to educate folks"

PG&E, **Cisco Systems**, and **General Electric** are all betting that energy-monitoring devices will catch on in homes. Convincing consumers that the gizmos are a good thing is turning out to be a tough sell.

Power companies have traditionally relied on workers walking house to house to monitor electricity use. Smart meters are designed to give utilities a real-time picture of electricity consumption, eventually allowing them to create pricing plans that will encourage conservation during peak hours. Around 43 percent of U.S. homes will have the new meters by 2014, according to forecasts from researcher Parks Associates, up from 14 percent at the end of last year.

Even with $3.4 billion in U.S. stimulus funds behind it, the race to install smart meters is starting to lose momentum. In Hawaii, regulators rejected a $115 million plan in July by **Hawaiian Electric** to install smart meters that residents and businesses would pay for. Almost a dozen California cities and counties have asked regulators to halt installations, saying the devices send inaccurate data to utilities. Homeowners in Bakersfield, Calif., have filed a class action against PG&E, accusing the utility of overcharging since smart meters were installed in homes. "The meters don't benefit the consumer; they cost a lot of money, and we can't opt out," says Joshua Hart, the California-based director of Scotts Valley Neighbors Against Smart Meters.

FROM LEFT: RYAN ANSON/BLOOMBERG; COURTESY ITRON INC.; PHOTOGRAPHS BY TIMOTHY ARCHIBALD FOR BLOOMBERG BUSINESSWEEK

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A study by independent consultant The Structure Group found that PG&E's smart meters are more accurate than the older versions they replaced. PG&E spokesman Paul Moreno says the meters will save customers money over the long term.

Utilities and the companies that manufacture the meters are joining together to overcome the mounting resistance. In March, GE, **IBM**, and **Silver Spring Networks**, among others, formed the Smart Grid Consumer Collaborative to sell consumers on the benefits of the technology. "We, as an industry, need to continue to educate folks. That is a good part of the problem," says Ron Sege, chief executive officer of **Echelon**, a Silicon Valley company that makes hardware and software for smart meters to communicate with utilities.

Consumer opposition isn't the only obstacle: Power companies must also get the approval of public utility commissions before deploying the meters, a process that has been stymied in some states. **Duke Energy**'s proposal to install 800,000 meters in Indiana was rejected by regulators because of concern that the cost of the project would outweigh potential benefits to consumers. The company is awaiting a decision on a pilot plan encompassing just 40,000 households. The Charlotte (N.C.)-based utility is also taking more time to build support for the changeover in Ohio, where it already has received approval to install about 1.2 million meters. "We've taken a more paced, deliberate approach to try to get in front of customers and those stakeholders groups as soon and as early as possible," says Mark Wyatt, vice-president for smart grid and energy systems at Duke Energy.

Despite the roadblocks, companies continue to invest heavily in meters. On Sept. 2, Cisco announced plans to buy **Arch Rock**, a San Francisco company that makes wireless technology to transmit data from smart meters to utilities. Says Charles Carmel, Cisco's vice-president for corporate development: "The smart grid will be a multibillion-dollar opportunity for players like Cisco and others for a number of years to come." Ⓑ

—*Joseph Galante and Mark Chediak*

The bottom line *Utilities and companies that make smart meters are uniting to overcome resistance from consumers in California and elsewhere.*

Innovator

Andrew Thompson



The venture capitalist and entrepreneur wants to put chips into pills, turning them into networked drugs that warn patients when they miss a dose

Modern cars come with a bevy of dashboard alerts, from the "check engine" light to the low-oil warning. "That's why cars rarely break down," says Andrew Thompson. The human body has no corresponding system, and as a result, "people break down all the time. The tow truck is called the ambulance."

Thompson is trying to create the medical equivalent of a dashboard alert. The chief executive officer and co-founder of Redwood City (Calif.) Proteus Biomedical is developing ingestible chips that can be embedded in pills, turning them into networked, digital drugs. The technology, says Thompson, will reduce the likelihood of a patient missing a dose, which for those with serious conditions can lead to complications or even death.

Thompson, 47, has dubbed his creation the Raisin System. The one-millimeter-square Proteus chip is activated by a patient's stomach fluids and sends a signal to a Band-Aid-size computer worn on the body. The computer uses Bluetooth wireless technology to communicate with the patient's mobile phone, which alerts patients (or their caregivers) when they forget their medicine. The computer, which also has an accelerometer to monitor physical activity and skin sensors to record heart rate, can contact a doctor if health problems develop. The system has been tested in trials for drugs that treat heart failure, hypertension, tuberculosis, and other diseases.

"It's an enormous vision," says Proteus board member Ryan Schwarz, managing director at the Carlyle Group, an investor. Novartis and Medtronic also are backing the company, which has more than $100 million in funding, says Thompson.

Thompson holds an engineering degree from Cambridge University and an MBA from Stanford and is a founding partner of Spring Ridge Ventures, a venture capital firm focused on the health sector. He came up with the idea for Proteus in 2003, while attending an American Heart Assn. conference. He realized that implantable medical devices such as defibrillators don't track the intake of drugs. Proteus has filed for several hundred patents. Thompson has put the names of each of the company's roughly 100 staffers on foot-high glass containers in the lobby. When employees file for a new patent, they earn a small foam brain to put inside their jar.

Other companies are working on technology similar to the Raisin, but Proteus is one of the closest to market, says Trevor Mundel, global head of development for Novartis. The drug company plans to use the system next year in a trial for a transplant drug, he says.

Raisin-enabled drugs may hit the market as early as 2012. The chips are safe to eat, says Thompson, who has tried them. They're made of small amounts of common elements such as silicon and magnesium. "There's more silicon in a banana," he says. Ⓑ —*Olga Kharif*

Education ▶ Engineering at Cambridge; MBA from Stanford
Invention ▶ A digestible microchip small enough to fit inside pills
Motivational Trick ▶ Awards toy brains to innovative employees





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As Pessimism Grows, Is It Time to Buy Stocks?

▶ **Contrarians see people's disenchantment with the market as a sign a rally is imminent**

▶ **"Investing in equities has been like slogging through the rain for the past 10 years"**

Americans continue to be wary of stocks. The Standard & Poor's 500-stock index is almost unchanged since the end of 2009, and mutual fund investors have yanked money from equities for four straight months. Activity in the options market shows that concern has never been higher that stocks will plunge. At the same time, other indicators, including cash flow and dividend yields, suggest equities are attractively valued. It all adds up to a contrarian's dream and a plausible case for buying stocks.

"Just look at three things: compelling valuation metrics, the sheer fundamentals in some areas like profitability, and this huge disconnect between how people are perceiving things and the reality of how they are," says James Paulsen, chief investment strategist at Minneapolis-based Wells Capital Management, which manages $342 billion. "Therein lies the big opportunity."

One argument for buying stocks now is that individual investors seem to have lost faith in them—which in the past signaled a rally was imminent. People burned by the 2008 financial crisis got another reason to be wary on May 6, when the market plunged, erasing $862 billion from U.S. equities in 20 minutes, before recovering. Investors have withdrawn almost $57 billion from mutual funds that invest in U.S. stocks since the beginning of May, the most in any four-month period since 2008, according to data compiled by the Investment Company Institute, a Washington-based trade group.

At the same time, they have put about $597 billion into bond funds, according to ICI, even though stocks appear to offer better values. As of Aug. 31, 68 stocks in the S&P 500 paid dividends that exceeded the average corporate bond yield of 3.8 percent, more than any time in at least 15 years, data compiled by Bloomberg and Bank of America show. Free cash flow produced by companies outside the financial industry represented 6.8 percent of their stock prices last month. That's the highest since 1960 when measured against the average investment-grade corporate bond yield, according to Zurich-based Credit Suisse.

There's "this huge disconnect between how people are perceiving things and the reality"

"I think the confidence in bonds is a bit misplaced," says John Carey, Boston-based money manager at Pioneer Investments, which oversees about $230 billion. "People who have been burned by the stock market are putting money there, but now they're underweight in equities."

Professional investors are also nervous. Futures on the CBOE Volatility Index are pricing in a three-month volatility increase of more than

ILLUSTRATION BY YVES SALTT

30 percent, meaning traders expect the markets to get even more wobbly. The VIX, as the index is called, measures the cost of options that protect against losses in the S&P 500. Expectations for higher volatility suggest too much pessimism, according to Pierre Lapointe, global macro strategist at Brockhouse Cooper in Montreal. His firm oversees $500 million and advises more than 200 asset managers worldwide. "Negativity in the market is very, very high," Lapointe says. "We're still bullish and think the recent soft patch is normal in an economic recovery pattern."

At least some investors share Lapointe's view: Commodity producers are fetching the richest valuations in the S&P 500, a sign of confidence in the global recovery. The 32 mining companies, seed makers, and chemical suppliers in the S&P 500 recently traded at 18.7 times the past year's earnings. That's the highest price-earnings ratio among the 10 industries in the index and 3.9 points above the S&P's average p-e of 14.8. When the group's valuation was that much higher than the S&P 500's in 2004, the index was at the start of a five-year rally in which it doubled.

Signs of recovery continue to accumulate. The labor market has improved, with initial jobless claims falling in the week ended Sept. 4 by more than economists forecast. Companies added more jobs in August than projected. Retail sales climbed more than expected for a second straight month, while factory production increased. Pending home sales unexpectedly rose. The outlook for corporate profits remains robust, with analysts projecting gains of 36 percent in 2010, the highest since 1988, and 15 percent in 2011, according to estimates compiled by Bloomberg. S&P 500 companies that have reported second-quarter earnings since July 12 have beaten forecasts by 11 percent.

Yet no one knows when a prolonged rally might begin—or what it will take to ignite one. Sustained job growth, consistent improvement in the housing market, or stabilization in the European Union economies may lure money back to stocks, says Alan Gayle, senior investment strategist at RidgeWorth Capital Management in Richmond, Va., which oversees $63 billion. "For a lot of retail investors, investing in equities has been like slogging through the rain the past 10 years," he says. "They need a sign. They want something they can see, they can touch, they can feel. The question is what ... is going to generate that sustained growth?" —*Whitney Kisling*

***The bottom line** Signs of nervousness about stocks are convincing contrarian investors that this is a smart time to put money into the market.*

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Bankruptcy

Two Years Later, Lehman Lives On

- Creditors may end up getting 15¢ to 44¢ on the dollar
- Its "litigation strategy is optimistic" but has "some chance"

On Sept. 15, 2008, the bankruptcy of **Lehman Brothers Holdings** helped trigger the worst recession since the Great Depression. Two years later the failed investment bank is a business again. It has 500 employees and almost $20 billion in cash on hand. It shells out up to $45 million a month to pay its staff, outside managers, and advisers and is spending tens of millions of dollars on litigation expected to run at least until 2012.

Lehman is taking an unusual approach for a bankrupt company that's liquidating. Yet it could be the best strategy for the bank's creditors. Lehman Chief Executive Officer Bryan Marsal, 59, says he intends to raise $40 billion to $50 billion by selling Lehman assets over the next five years; selling soon after the 2008 financial crisis might have brought $20 billion or less. Even so, Lehman has said creditors ultimately may get only about 15¢ to 44¢ on the dollar.



Don't Look at Women's Legs for Market Guidance

Hemlines have often mirrored Wall Street's mood, rising when stocks soared in the 1920s and '60s, falling in the late '40s. This year the styles on display at New York City's Fashion Week gave an appropriately mixed message. "Hemlines are all over the place, very much like the stock market," says Robert Burke, president of retail consulting firm Robert Burke Associates. —*Katya Kazakina*

FROM LEFT: H. ARMSTRONG ROBERTS/CLASSICSTOCK/CORBIS; AP PHOTO; GETTY IMAGES (5); GERALD HOLUBOWICZ/POLARIS; NELSON CHING/BLOOMBERG

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The Lehman building in Manhattan on the day of the bankruptcy filing

Lehman "is acting like an ongoing investment concern," says Lawrence A. Larose, a lawyer with Winston & Strawn's financial restructuring practice in New York, which is not involved in the case. There's general agreement among creditors, Larose adds, that to "just dump these tens of billions of assets into a very questionable market will destroy value."

The distressed ventures Lehman bankrolled range from Hawaii's 463-room Ritz-Carlton Kapalua resort, on which it is seeking to foreclose, to a boarded-up hospital building in Oakland, Calif., on a site that used to house transients, according to a court filing in Lehman's bankruptcy case. In April, Lehman won court approval to set up a unit called Lamco to manage some of its real estate, private equity investments, derivatives, and corporate loans for five years.

Along with selling assets, Marsal, who has been Lehman's CEO since 2008, intends to use lawsuits to recover money for creditors. From **Barclays**, Lehman wants as much as $11 billion because of what it calls the "windfall" the U.K. bank reaped as a result of its purchase of Lehman's defunct brokerage. Lehman also has sued **JPMorgan Chase**, claiming that the bank helped cause its collapse by demanding $8.6 billion in collateral as credit markets contracted in 2008; it put the damage at billions of dollars. Both banks have denied wrongdoing and are fighting back. The Barclays trial in bankruptcy court will continue at least through this month. JPMorgan's is set for 2012. "Lehman's litigation strategy is a bit optimistic, but they have some chance of getting money out of this," says Claude R. "Chip" Bowles, a bankruptcy lawyer at Greenebaum Doll & McDonald in Louisville, who has written about Lehman.

Lehman filed the biggest U.S. bankruptcy ever in September 2008, with $639 billion in assets. Creditors include **Goldman Sachs**, **UBS**, the **New York Giants**, and the Abu Dhabi Investment Authority, as well as individuals who hold Lehman bonds. Lehman hasn't announced when it will pay creditors, saying only that distributions must wait until after its reorganization plan is approved, possibly in the first half of 2011. Through July, Lehman handed out almost $918 million to its managers, lawyers, and other advisers, including $326 million to **Alvarez & Marsal**, Marsal's restructuring firm. Alvarez & Marsal also stands to collect a portion of the money it recovers for creditors.

Lehman's spending already tops the $757 million price tag for energy trader Enron's three years of bankruptcy, according to data compiled by Lynn M. LoPucki, a bankruptcy law professor at the University of California, Los Angeles. Lehman is the Jarndyce and Jarndyce of our time, says Nancy B. Rapoport, a bankruptcy law professor at the University of Nevada, Las Vegas' William S. Boyd School of Law, referring to the almost interminable case in Charles Dickens' *Bleak House*. "It has no economic reason to stop." *—Linda Sandler and David McLaughlin*

The bottom line *To recover more money for creditors, Lehman CEO Marsal is holding on to distressed assets, hoping they'll gain in value.*

Energy Markets

A High-Wire Act for Nigeria's Oil Minister

▶ At home, Alison-Madueke, OPEC's first female minister, is under fire

▶ "She has no clue what our struggle is all about," says a Nigerian critic

Diezani Alison-Madueke will take her seat as the first female oil minister in OPEC when the group meets in Vienna next month. Far tougher, though, is the delicate dance that she's performing at home in Nigeria. President Goodluck Jonathan, up for reelection in January, appointed Alison-Madueke his Petroleum Resources Minister in March. She has the unenviable job of negotiating with the foreign energy companies that pump most of the country's oil while also dealing with insurgent groups, angry about the distribution of oil profits, whose armed attacks have slowed energy investment in Nigeria.

Her first task is to guide a bill through Parliament that would increase taxes on overseas oil companies and take a bigger share of profits from the country's joint ventures with big oil companies. Another government initiative, announced last October, will allocate the equivalent of 10 percent of the nation's petroleum wealth to the Niger River Delta region (Alison-Madueke hails from that area) to appease the militants.

Looking after the country's all-important energy sector–Nigeria has Africa's second-biggest crude oil reserves after Libya and its largest gas depos-

Quoted

"I know our system is down today. I apologize for that."
—JPMorgan Chase Chief Executive Officer Jamie Dimon, commenting on an outage that knocked out the bank's consumer website last week



its–"comes with a great onus of responsibility," Alison-Madueke, 49, says in an interview in London.

The daughter of an oil executive at what is now **Royal Dutch Shell**, Alison-Madueke studied architecture at Howard University in Washington and received an MBA from Cambridge University in the U.K. In 1993 she joined Shell's operation in Nigeria, where she rose to become the company's first female executive director. (Shell has been criticized for its business practices and environmental record in Nigeria, and its facilities have come under repeated attacks from armed rebels.)

When OPEC meets in Vienna on Oct. 14, Alison-Madueke will push to increase Nigeria's OPEC quota, which she says was set during a period (from 2006 to 2009) when militant attacks cut the country's oil production by 28 percent. Nigeria's official quota is 1.673 million barrels a day, although it pumped about 2 million barrels a day last month, according to Bloomberg estimates. "We would in fact like to review those levels," says Alison-Madueke, who thinks the quota should be increased to reflect a rebound in oil production as fighters have disarmed in response to a government amnesty program.

A more difficult task may be implementing the energy legislation, expected to pass Parliament in the coming weeks, without alienating foreign oil companies. Shell, **Chevron**, and **Exxon-Mobil** say the new law would make it unprofitable to invest in Nigeria's deepwater fields.

Alison-Madueke is an Ijaw, the predominant ethnic group in the oil-producing region from which the militants have drawn much of their membership. So far that hasn't proven much of an advantage. Alison-Madueke is too "elitist" to empathize with the militant cause, Jomo Gbomo, a spokesman for the Movement for the Emancipation of the Niger Delta, wrote in an e-mail. "She has no clue what our struggle is all about." Environmental Rights Action (ERA), the Nigerian affiliate of Friends of the Earth, says her connection with Shell makes her appointment more than a coincidence. "It is curious that a product of Shell was chosen to oversee the passage of the reform bill after Shell had criticized it," Nnimmo Bassey, the head of ERA, said by phone from Benin City, Nigeria. For its part, Shell is "pleased" that a former employee is serving in the Cabinet, but it "doesn't seek nor expect any preferential treatment," Tony Okonedo, the company's spokesman in Nigeria, wrote in an e-mail. Alison-Madueke says she is confident she can deal effectively with foreign oil companies and look after Nigeria's national interest. "I can see things from both sides of the spectrum," she says.
—*Dulue Mbachu*

The bottom line *Nigerian Oil Minister Alison-Madueke hopes to keep foreign energy companies happy while shifting more oil wealth to the government.*



Alison-Madueke: Job One is a bill that will raise taxes on the oil majors

Investment Banks

Wall Street Trading Is Still a Black Box

▶ **The firms lump trading results together, potentially masking risk**

▶ **"What I have is succotash, and it's very difficult ... to analyze"**

It took a congressional inquiry this year to force **Goldman Sachs** to disclose how much it made in the mortgage market–and that was only for 2007. The Wall Street bank hasn't revealed mortgage-trading revenue since then. That leaves investors to guess how much that contributes to the fixed-income, currency, and commodities division, or FICC, which also trades junk bonds, yen, oil, and uranium, sells weather derivatives, and operates power plants.

While the company gives directional hints about the performance of the businesses within FICC in press releases about its quarterly earnings, that's not good enough for Mike Mayo, a bank analyst at Crédit Agricole Securities USA in New York. "That's just one big black box," he says. "You can't get around it."

Wall Street firms' tendency to hoard information about markets and how they make money has come under scrutiny after investors were caught by surprise in 2007, when confidence in everything except Treasury securities vanished and credit markets collapsed. Lawmakers and regulators are pushing firms to move derivatives trades onto clearinghouses, where prices can be monitored, while demanding fuller disclosure on consumer loans. Yet the Dodd-Frank Act, designed to prevent future financial crises, does little to improve investors' ability to analyze results at the five biggest U.S. firms that trade securities for clients and their own accounts–Goldman Sachs, **Citigroup**, **JPMorgan Chase**, **Bank of America**, and **Morgan Stanley**.

Investment banks combine the results of trading categories to keep them secret from competitors and trading partners and to smooth out gains and losses from swings in individual markets, says Adam Hurwich, a former member of the Investors Technical Advisory Committee of the Financial Ac-

LEFT: REUTERS

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What's brewing for Pabst page 62 ▶

counting Standards Board (FASB) who's now a partner at hedge fund Jupiter Advisors in New York.

The resulting opacity undermines confidence in the firms' results, says Brad Hintz, a former Morgan Stanley treasurer and Lehman Brothers Holdings chief financial officer. "Nobody believes the brokerage firms right now," says Hintz, now an analyst at Sanford C. Bernstein in New York. "When you're mixing euros and yen and dollars together, and then on top of that you're throwing in commodities, what I have is succotash, and it's very difficult for us to analyze."

The issue has taken on greater significance as the trading businesses have grown. The banks reported $79.9 billion in FICC revenue in 2009, more than double the amount in 2004. FICC accounted for 22 percent of the banks' total revenue last year vs. 14 percent in 2004. Goldman Sachs' FICC division last year brought in $23.3 billion, or 52 percent of the firm's total, making it the biggest based on revenue and the percentage of overall revenue. Spokesmen for Goldman Sachs, Citigroup, Bank of America, and Morgan Stanley declined to comment. Kristin Lemkau, a spokeswoman for New York-based JPMorgan Chase, says the bank tries to "provide sufficient disclosure to allow investors to make informed decisions about our business."

U.S. accounting rules allow companies "quite a bit of latitude" in how much detail to disclose about business segments, says Regenia Cafini, a project manager at the Norwalk (Conn.)-based FASB, which sets bookkeeping standards. Companies are supposed to break out business segments whose "results are reviewed regularly" by the "chief operating decision maker," typically the CEO or chief operating officer.

A July proposal by FASB staff to be considered later this year would require banks to report income and expense items "so that the information is useful in understanding the activities of the entity." Absent that, "there really aren't rules per se on defining a segment," Cafini says. "It's how the company sees itself. I'm a manufacturing company, and I make clothing. I could segment myself by shirts and pants and belts ... or I could lump them all together."

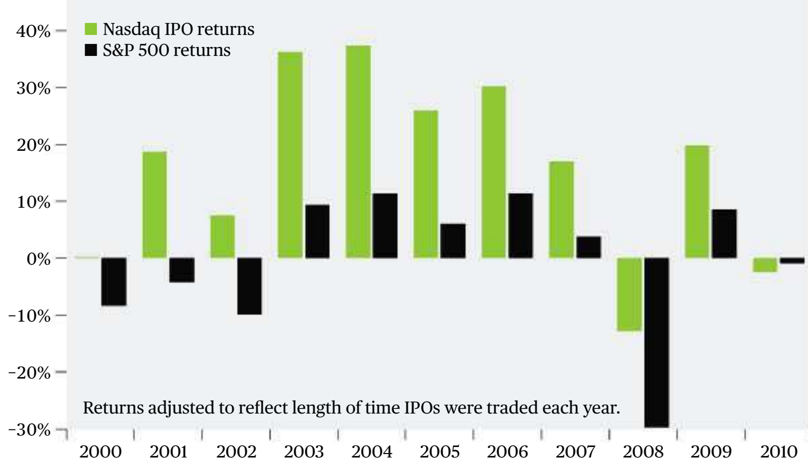
Former Securities and Exchange Commission Chairman Harvey Pitt thinks pressure from regulators and investors will force banks to be more forthcoming. "They're going to resist it, but they're going to have to disclose more," says Pitt, now chief executive officer of Kalorama Partners, a Washington-based consulting firm. "If there's one thing we've learned from the financial crisis, it's that a lack of transparency is absolutely devastating." *—Bradley Keoun*

The bottom line *Wall Street banks still don't divulge much about their trading, making it hard for investors to know how much risk the firms are taking.*

Investing

An Off Year for Nasdaq IPOs

Initial public offerings on the Nasdaq are lagging the return of the S&P 500-stock index for the first time on record. Over the past decade, Nasdaq IPOs have more than doubled the benchmark's return every year. *—Michael Tsang*



Returns adjusted to reflect length of time IPOs were traded each year.

Takeovers

Get Ready for a Wave Of Bank Mergers

▶ Acquisitions may be the only way for some institutions to grow

▶ PNC's ability to digest another bank is "higher than it has ever been"

Banks have a problem. Loans outstanding have dropped 10 percent since October 2008, the sharpest contraction in more than 35 years, according to Goldman Sachs. That's left them with unused lending capacity, idle cash, and depressed market values. As analysts at Keefe, Bruyette & Woods, Rochdale Securities, and CreditSights see it, those conditions make the industry ripe for a wave of takeovers that could rival the buying binge of 2001 to 2007.

This time, the four biggest banks won't be doing any significant buying. **Bank of America**, **JPMorgan Chase**, and **Wells Fargo** each controls something in the neighborhood of 10 percent of U.S. deposits, the most permitted by regulators when considering takeovers, and **Citigroup** is trying to sell assets. The absence of those banks may keep prices down in any merger wave. And it leaves the field to regional banks such as **U.S. Bancorp** and **PNC Financial Services Group**. "Those companies have the luxury of looking at anything," says KBW analyst Christopher McGratty.

Acquirers are more likely to strike than they were last year now that the industry has stabilized. "If you feel you have a fair assessment of what your own assets are worth, you feel better about looking at others," McGratty says.

Markets&Finance

Many potential targets are attractively valued. The price-to-book-value ratio of the 24 companies in the KBW Bank Index is 0.9, down from an average of 2.1 from 1993 through 2006, according to Bloomberg data. The ratio is one of Wall Street's main gauges for bank shares.

Banks trading at large discounts include **SunTrust**, **Regions**, and **Marshall & Ilsley**, according to Richard X. Bove, an analyst at Rochdale Securities in Lutz, Fla. Atlanta-based SunTrust trades at about 0.7 times book value, Regions at 0.6, and Marshall & Ilsley at 0.7, according to Bloomberg data. Spokesmen for Birmingham-based Regions, Alabama's biggest bank, and Marshall & Ilsley, based in Milwaukee, declined to comment.

U.S. Bancorp, PNC, **BB&T**, and **People's United Financial** have all made acquisitions, and their executives say they're hunting for more. Minneapolis-based U.S. Bancorp, ranked fifth by deposits, has acquired at least 10 banks since the credit crunch started and will continue to "opportunistically acquire," Chief Executive Officer Richard K. Davis said in a July conference call. PNC, now ranked sixth, finished integrating National City branches and accounts in June, six months ahead of plan, CEO James E. Rohr said in a July conference call. PNC's confidence that it can digest another bank "is higher than it has ever been," he said.

The pace of consolidation will quicken if the economy, loan demand, and interest rates fail to rebound. When borrowers repay loans, banks have nowhere to put the cash except lower-yielding securities. "That pressure is going to continue to mount into 2011" and push banks into deals, says analyst David A. Hendler of CreditSights in New York. In that kind of environment, says Paul J. Miller, an analyst at FBR Capital Markets in Arlington, Va., "the only way you are going to grow assets is to buy another bank." B

10%

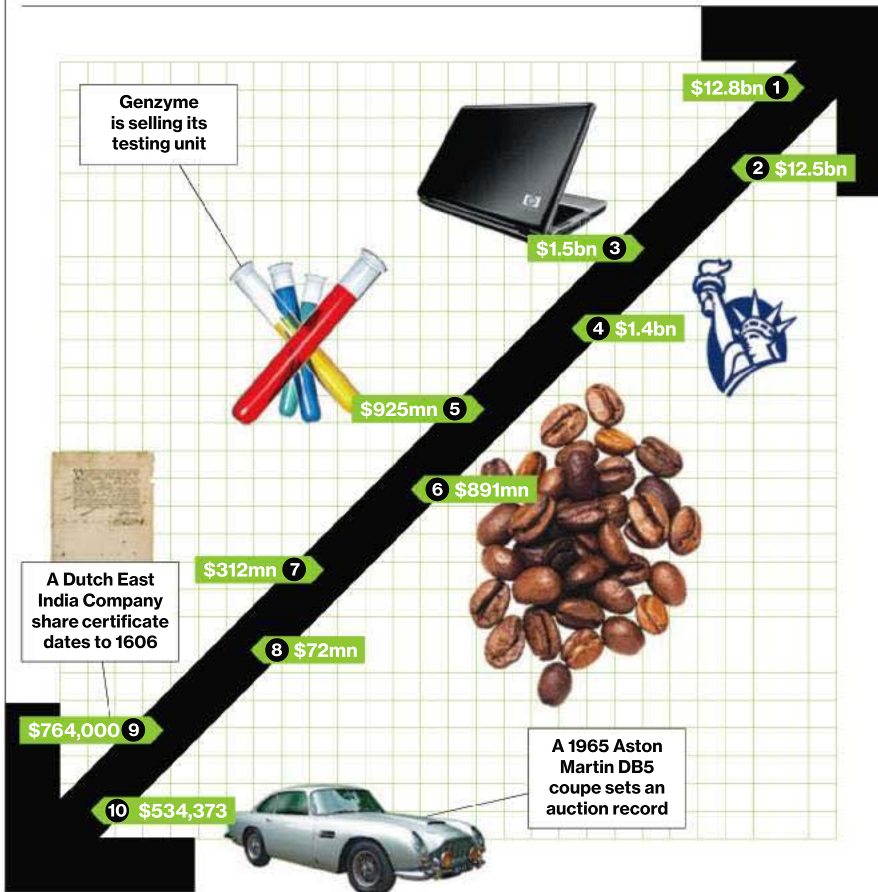
The drop in bank loans outstanding since October 2008

—David Henry and Dakin Campbell

The bottom line *Conditions in the banking industry favor a new round of takeovers, though the largest players may be too big to participate.*

Bid & Ask

by Cristina Lindblad



1 **ICAP**, the biggest broker of transactions between banks, handled more than $12.8 billion of interest rate swaps during the first week of its new electronic market. The exchange, launched on Sept. 6, is seeking to capitalize on demands from regulators for more transparency in the $615 trillion market for over-the-counter derivatives.

2 **Deutsche Bank** plans to raise at least $12.5 billion in its biggest-ever share sale. It will use proceeds to fund its takeover of Deutsche Postbank and meet stricter capital requirements.

3 **Hewlett-Packard** is paying $1.5 billion for ArcSight, a Silicon Valley company that makes software to identify suspicious activity on corporate networks.

4 **Liberty Mutual Agency**, a writer of property and casualty insurance, hopes to raise as much as $1.4 billion in what would be the biggest U.S. initial public offering so far in 2010.

5 **Genzyme** agreed to sell its diagnostic testing unit to Laboratory Corp. of America for $925 million. Genzyme is divesting some of its units to boost its stock price, a move that may force Sanofi-Aventis to raise its outstanding takeover bid for the biotech company.

6 **Green Mountain Coffee Roasters** is acquiring Van Houtte, Canada's largest coffee roaster, for $891 million.

7 The palatial **Monaco penthouse** of the late billionaire banker Edmond Safra has been sold for $312 million. The 17,500-square-foot duplex—which has 30 rooms, including a panic room—underwent a multimillion-dollar renovation following the 1999 fire that killed Safra.

8 New England Patriots quarterback **Tom Brady** got a four-year contract extension worth $72 million.

9 A recently discovered share certificate for the **Dutch East India Company** dating from 1606 may be worth up to $764,000, according to appraisers, who say it may be the world's oldest.

10 A 1965 **Aston Martin DB5 coupe** sold for $534,373, an auction record for the model. Vintage sports cars are fetching record prices as jittery investors turn to hard assets.

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(from left)

Robert Shiller
Yale University professor; housing expert; author

Henry Kaufman
Consultant; former Salomon executive; author

Peter Orszag
Former director, Office of Management & Budget

Bill Gross
Managing director, Pimco

Charles Calomiris
Henry Kaufman Professor, Columbia University



How to Fix the Economy

A spirited debate, moderated by Tom Keene Photographs by Henry Leutwyler

On September 7,

Bloomberg Businessweek brought together four top economists and one eminent money manager and gave them the following tough assignment: fix the American economy. Eleven days before, at an annual gathering of central bankers in Jackson Hole, Wyo., the influential University of Maryland economist Carmen M. Reinhart had presented a paper forecasting high unemployment, low housing prices, and very low growth through 2017. That grim forecast was on the minds of our roundtable, which included Yale University professor Robert J. Shiller, author of *Irrational Exuberance*; Peter R. Orszag, who recently stepped down as director of President Obama's Office of Management & Budget; financial consultant and former Salomon Brothers Managing Director Henry Kaufman; and Professor Charles W. Calomiris, who is the Henry Kaufman Professor of Financial Institutions at Columbia University. Pimco Managing Director William H. Gross, who runs the world's biggest bond fund, joined the group by telephone. The discussion was moderated by Tom Keene, co-host of *Bloomberg Surveillance*. What follows is a condensed, edited transcript.

How do we get out of this mess?

Bill Gross: You have to ask how we got into it—and what Carmen Reinhart presented at the Jackson Hole conference was probably the best explanation: An expansion in credit, debt, and deregulating over the past 10 or 20 years got us here. It was a 10- to 20-year process moving in, and it will probably take a long time moving out. Some have suggested the Biblical seven years fat and seven years lean.

Peter Orszag, now that you are out in the real world, give us a time continuum.

Peter Orszag: I would agree with Bill that this is going to take a while. We are in the mode of years rather than quarters.

Henry Kaufman: I believe it will take time, but it need not take time. What can we do about the debt position of households, businesses, and the American government? We are unwilling to do drastic things that will improve the situation of households. You can do that by raising their income so they can meet their debt burdens. Or you can do something about the size of that debt. We don't have the capacity or the willingness to do that.

Charles Calomiris: What typically happens in these kinds of financial crises is that the problem switches from being a private-sector leveraging problem to a public-sector leveraging problem. That is the major handoff—and we are in the middle of that handoff right now. So you could look at the private sector and find some room for optimism if the growth rate of the economy could get going.

The problem is that the public-sector debt is a terrible drain on the growth rate of the economy. And what we know from history is that when you get to the point where it starts looking like you are in an unsustainable fiscal path, the tax increases and high interest rates that come from that are a threat to long-term growth. So you get into a bad equilibrium driven by the public debt problem. Without drastic reforms to entitlement programs in the United States, we are really talking about something that will feel like the 1970s—but last for 20 to 25 years.

Robert Shiller, tell us how housing links into this mess.

Robert Shiller: Housing is, for most people, the biggest part of their wealth. We went through a bubble-and-burst cycle—that was the single biggest cause of this crisis. Now we have so many underwater, and so many unemployed, that it is creating a lack of confidence. One question is, should we reinstate the Home Buyer Tax Credit in an effort to push home prices up? That did succeed, but it seems to be unraveling at the other end, and I am afraid home prices may go down [further]. We should be thinking about modernizing our housing sector, improving the kind of mortgages we offer and encouraging innovation.

Orszag: Let me return to the out-year fiscal problem Charles raised. Over the long term, it is clearly right that entitlements are the key issue, and we should talk about health care because that is the core of the long-term problem. But if you are looking at the next five or ten years, the nature of our problem is fundamentally different. I don't think you are going to be able to get the majority of the fiscal adjustment necessary in 2015 or 2016 on the spending side of the budget.

Social Security changes will be gradually phased in and will protect current and near-retirees, which means their impact by 2015 is very modest. Most of the politically feasible Medicare and Medicaid offsets were part of the health-care bill, so the [odds] you are going to get a lot more by 2015 are not overwhelming. If you look at nondefense discretionary spending, even if you cut 5 percent from that, that is 0.2 percent of GDP. So the majority is going to have to come on the revenue side for the medium term.

Calomiris: I disagree with Peter when he says we just can't get more than a 5 percent cut in nondefense discretionary spending. Nonsense! During the Bush Administration and in the last two years, we have substantially increased government expenditures. Government expenditures as a fraction of GDP are way too high. We need to go back and think about where we were ten years ago and think about rolling back those programs, because we are broke.

Orszag: Can I just jump in with some

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facts here? The increase from about 20 percent of GDP to roughly 24 to 25 percent of GDP in government spending over the past couple years came from a set of very temporary things that are not there in 2015 or 2016.

Calomiris: I wasn't just talking about the last two years.

Orszag: I understand, but go out to 2016. Half of the budget is Social Security, Medicare, and Medicaid. Take out net interest and you are at defense and nondefense discretionary spending. Defense already assumes a phasedown in the war. Nondefense discretionary spending is 4 percent of GDP. There is no plausible way you are going to get more than 0.2 percent or 0.3 percent of GDP on that.

Calomiris: We agree that entitlements are where all the action is, Peter. I am just saying, arguing that we need to raise taxes to solve our problem is not a good idea. Arguing that we are going to spend more money to solve this problem is acting like we are in an aggregate demand problem when we are in a very long-term growth problem.

Orszag: I don't think the solution is just on the revenue side. The point is, the medium-term fiscal problem is fundamentally different from the long-term fiscal problem.

Calomiris: There is only one fiscal problem, and it is long-term. If you cut entitlements, the market will reward you. It doesn't care about the next two years.

Kaufman: One of the big issues on the housing front is Fannie Mae and Freddie Mac. I don't think we are going to modernize Fannie and Freddie very soon. Fannie and Freddie hold the preponderance of mortgages in the United States. They provide a subsidy to households. If you turn it over to the private sector, households will have to pay more.

Gross: I almost totally agree with Henry on this one. And I take it from a market perspective: Non-Fannie and Freddie mortgages trade in the 6-to-8 percent category, as opposed to the 3½-to-4 percent category [for Fannie and Freddie mortgages]. Those that argue for a more private orientation toward housing, that may be fine 10 to 15 years out. But over the next five years, the private market can't really step in for Fannie and Freddie.

Calomiris: I understand that point, but I disagree with the conclusion. To me the problem preventing the private market from getting started taking over the burden is a lack of loss recognition. Because Fannie and Freddie are effectively government agencies, they are willing to pretend to continue the game in ways that the private sector wouldn't. Remember, the leveraging we saw in the 2000s was driven by government subsidies. Fannie, Freddie, and the FHA went to unprecedented leveraging limits. And we don't want to continue that. What we want to do is make the tough decisions to accept the losses that exist, write down mortgages. And when we do that we can restart the private mortgage [sector].

Gross: That is not sufficient. What has been recognized in the private market is that housing prices can go down and not simply up. To suggest that we recognize losses and go on our merry way is—

Calomiris: Let me clarify. I am not saying just an accounting exercise. I am talking about a fiscal exercise. I am talking about actually subsidizing the recognition of losses. So, the Mexican government in 1999 did a program where they did loss sharing with private creditors, which accelerated the recognition of losses and absorbed some percentage of the loss. It was very effective. That is the kind of program I have in mind.

Shiller: The Dodd-Frank bill calls for a HUD study of shared appreciation mortgages [in which the lender loans money in return for a share of the future increase in the property value]. Let's think about it. We got into this crisis partly because homeowners were heavily leveraged in the only asset they hold, their home. If home prices fall, they are going to be underwater and they are going to be panicking. So the HUD study, which is supposed to come out about the end of this year, will lead to a change in household mortgage financing. We could also encourage more rentals; then people could hold a diversified portfolio. That would bring us into the 21st century with more logical and sensible portfolios for households.

Kaufman: You are absolutely right. But when I listen to you, there is a timeline attached. You talk about some things that may be done, but before they begin more than a year will have elapsed.

Shiller: Roosevelt did things fast. He created the 30-year mortgage within months of his taking office. We need that kind of spirited innovation.

Well, spirited leadership and innovation, we turn to Peter Orszag. Where is it, Peter? How do we get rhetorical leadership that jump-starts us?

Orszag: Well, there is a rhetorical component, but there is also a legislative or policy component. The problem there is structural—a culture in Washington where people don't work together as well as they did in the past. Layer on top of that our political system, [which] never has been good at gradual long-term problems, and you have two structural problems facing our policy process.

Shiller: Sounds awfully pessimistic.

Orszag: We need to devise ways to overcome that, but I don't think there is going to be a knight in shining armor who rides in and fixes that.

Shiller: I thought the Dodd-Frank [financial reform bill] was an inspiration. You can criticize it, but it wasn't a dysfunctional Congress that did that.

The reason firms aren't hiring is the economy is growing so slowly; firms don't see the need to hire when they are growing at 1 or 2 percent a year.



Peter Orszag

Charlie Calomiris just fell off his chair over there.

Calomiris: Are we talking about the Dodd-Frank bill that was just passed? That 2,300-page monstrosity is the worst piece of legislation ever passed in U.S. history, and that is saying something. And I would wager that Bob hasn't really read it. I would like to talk about each section, Bob. I wonder, have you really read it?

Shiller: I can't claim to have read all of it, but I have read a lot of it, yes.

Kaufman: That legislation leaves a lot to be desired. The most difficult issue was Too Big to Fail, and that was not dealt with. We are going to be creating even bigger financial institutions, and the role of the smaller institution will diminish. And that leads me to something that Peter said. The President now is trying to do something to help small business, to provide some additional funding. The fact is, financial concentration has increased so much that relatively few financial institutions hold a massive amount of the financial assets of the U.S.

Big institutions are not geared to finance small business. They are geared to garner savings and investments and push them out on a wholesale basis. We would have moved toward solving the problem if we had broken up the large institutions where they are not too big to fail.

We need to think about rolling back programs, because we are broke. You will not tax and spend your way to high growth.



Charles Calomiris

So you would have broken up Pimco?

Kaufman: If it is too large, why not?

Gross: We have to recognize that there are still numerous institutions that are too big to fail, and that to allow them to fail in the current environment, and maybe even in the future environment, would simply be folly. We can pursue this fiction that regulatory changes have fixed it, but I don't think we can ever fix it.

Charlie, if the emotion of the moment is jobs, jobs, jobs, how do we jump-start that?

Calomiris: It is jobs that are affecting housing prices, not the other way around. Mainly it is the failure to generate convincing economic prospects that keep people from hiring. And there is a bigger problem out there too, and that is the prospect of a trade war between the United States and China. Let's remember, depending on how you count it, 16 percent of [Americans] would like to have jobs but don't.

That is a pretty big problem. About half of those people have been unemployed for almost two years. That we have never experienced in the United States. What is scary about that is not just the consequences for asset prices and for economic growth, but also the consequences for political backlash against global trade. So it would make sense to focus on some immediate policies that might address that. I have been advocating a payroll tax cut. It has to be long-term. It has to be big, something on the order of a 30 percent cut in Social Security taxes for four years. That would create immediate incentives for hiring.

Peter, what do you think of all these amateurs telling you we should cut the payroll tax?

Orszag: Well, if you had told me at a 9.5 percent unemployment rate there would be so little xenophobia and trade concern, I would have been quite surprised. It has been directed at Wall Street and corporate excess instead. So I am not sure that the biggest risk is backlash against China, as opposed to continued backlash against domestic institutions.

The key question is, Will a payroll tax holiday really spur hiring today?

When the Administration was floating the idea of a tax credit for hiring additional workers—which is similar in spirit to a payroll tax holiday, and ultimately a version was enacted—the pushback from corporate leaders was, "It is not really going to do very much. It is not responsive to the main reason we are not hiring." Now, I am not going to deny that changing the price of hiring workers [will] have an effect, but I don't think it is at the core of why firms are holding off. The key reason firms aren't hiring is that the economy is growing so slowly; firms don't see the need to hire more workers when they are growing at 1 or 2 percent a year.

Calomiris: I agree with you, Peter. But Tom's question was what could we do quickly right now. The bigger issues are concerns about uncertainty, marginal tax rates, health-care costs, energy taxes. There are huge unresolved issues.

Orszag: I would attack those.

Kaufman: I would favor some more public projects.

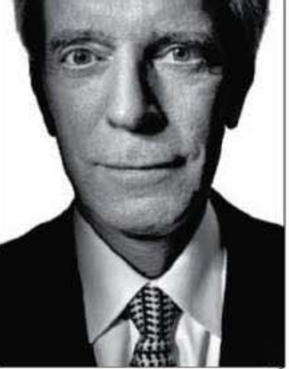
Shiller: Public projects are part of what we should be doing—New Deal, Civilian Conservation Corps-type projects—because unemployment is sapping the national morale. And we should restore general revenue sharing to state and local governments, which have to balance their budget because of their constitutions, [and] are laying off people who were doing something constructive. We have to stop that. This was a proposal initially of President Richard Nixon in his State of the Union Address in 1971. Until 1987, we had general revenue sharing in this country. We should bring it back on a temporary basis—maybe for five years.

Kaufman: We have to recognize the international dimensions of this problem. The choice is, Where do I acquire labor—in the United States or everywhere else in the world? That choice was not as great years ago as it is today. So part of this is a long-term problem: We have to enhance education from grade school all the way up so that the population becomes more competitive as a labor force.

Gross: The real problem is that the global economy faces a serious structural condition, and that is lack

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Bill Gross

What is required is to rebalance some of the production in Asian and other developing countries—and to put it back into the developed countries.

of global aggregate demand in which the developing countries continue to save and the developed countries no longer can finance prior levels of consumption. What is required is to rebalance some of the production that has taken place in Asian and other developing countries–and to put it back into the developed countries. The way you do that without trade restrictions is to force some type of currency realignment–which the Administration has been trying to do–but also to encourage China and other Asian countries to develop internally as opposed to simply externally for export.
Calomiris: I just don't agree with that. As much as I would like to see a redistribution of government expenditures toward infrastructure and education, the problem is we are broke. And we are not just broke once. We are broke about six times over in present value.

When a government is in an unsustainable fiscal position, spending more money does not improve the economy. And in fact, it can have disastrous negative consequences, especially once interest rates get wind of it. What we need to do is recognize that those state and local governments that Bob likes, they spent like drunken sailors during the boom. You will not tax and spend your way to high growth.
Kaufman: Let me just put this again in financial terms. The household sector is not a net new borrower. The business sector is not a net new borrower. State and local governments are nearly incapacitated as borrowers. The only one that has the capacity to borrow in sizable amounts is the U.S. government. And if the U.S. government for the near term is not going to borrow, we have a very serious problem.
Gross: To agree with Henry, what we have seen over the past year or two is a substitution of the government balance sheet, the government checkbook for that of the household. And to suggest that the government now contract fiscally in terms of reducing its deficits to me is simply going in the wrong direction.
Calomiris: I didn't say that. In fact, I agree. The deficit has to expand. I said cut spending and cut entitlements. Freezing discretionary, nondefense spending growth would be a great idea.
Orszag: That is what the Administration has proposed.
Calomiris: The key issue is not the next two, three years of deficits. I agree that those have to increase because of the state of the economy. The key issue is making the tough decisions about medium- and long-term entitlement spending and not raising taxes to choke off the little growth we have.

Bob, I get mail 30 to 1 saying, Just bring back a form of pay-go. People are starving for discipline out there. To jump-start confidence, how about a simple solution: Three years out, institute a more rigid form of pay-go. Would you get a confidence jump-start?
Shiller: There are many dimensions to trying to restore confidence. A plan to reduce the national debt is a relatively small part of it at this point. The really big thing is, people are very upset. They feel that the country is not theirs, and that a small group of wealthy people who get bailed out and bribe the government are in charge.
Orszag: There still is a lot of anger out there, no question about it. And just looking at the facts, it is not surprising. Our government stepped into a situation that was imploding. The shift in private-sector borrowing from plus 28 percent of GDP in 2007 to minus 17 percent of GDP in 2009 is stunning. It is not surprising that people are upset. In some sense, they should be. This is a traumatic thing to live through.
Kaufman: Underneath that was the effort to reform financial markets and institutions. And we still have to see how that is going to unfold. The legislation has contributed to uncertainty because we don't know yet what will be done with proprietary trading and securitization–what will the exact details be?
Shiller: The Congress isn't to be blamed for that. They had to do something, and they couldn't fix it all.
Calomiris: I disagree. They are to be blamed completely for it. They created such a mess of possibilities rather than addressing in a surgical way the problems that needed to be addressed.

There is a political mandate of "just do something," of FDR in 1932.
Kaufman: Well, he did do something. The separation of commercial banking from investment banking. FDIC insurance. A whole series of specific

We would have moved toward solving the problem if we had broken up the large institutions.

Henry Kaufman



issues that everybody clearly understood. The issues are not that clearly understood today. The system is more complex. What has been legislated is a Rube Goldberg contraption. And that is wrong.

Bill, there is a tendency here to talk dismal. What is optimistic right now as we enter the autumn of 2010?
Gross: Two big things. First, in terms of the global economy, there is a portion that is doing relatively well. The developing countries have an under-consumed economy, and they offer a more complex financial system going forward. The engine of global growth is shifting from the United States to other countries, but there is an engine—and that is helping to keep us above the line in terms of 1 to 2 percent economic growth.

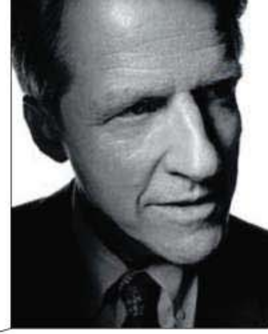
Secondly, interest rates are extremely low. They haven't done much in terms of positive economic growth, but to the extent that they stay low for a long time, then ultimately the ability to borrow—not just by big corporations but by smaller businesses and consumers alike—[should lead to a] regeneration of growth.
Kaufman: I would add that Americans are beginning to save more. And that is part of a readjustment process.
Orszag: I actually see a few things that are optimistic. Bill alluded to growth in the rest of the world. Export growth has reflected that. You are also seeing a pickup in equipment and software investments. Firms are not buying new buildings, but they are buying new computers. There are a bunch of sectors that are reflecting those forces—transportation equipment, for example.

So there are positive signs, but let me take a step back. The most important thing we have going for us is our entrepreneurship and flexibility. If our political system can help overcome a few of the problems we face, it will help unleash that underlying sense of optimism.
Shiller: I was going to list some of the things in the Dodd-Frank bill, which Charlie thinks is the worst. We are creating a Financial Oversight Council which will be worrying about systemic crises, and an Office of Financial Research, which is going to be collecting data. When we had this crisis we didn't know what was happening. We didn't have research on it. We have an Office of Housing Counseling that will help homeowners not get into the wrong mortgages. We are putting derivatives and swaps onto exchanges. All of these things are moving ahead.
Calomiris: I am going to short the stock market big time if the best Bob Shiller can come up with for optimism is the Housing Counseling Office.

What is the immediate to-do list?
Gross: It is jobs, jobs, jobs. And it is important to create jobs for the future, as opposed to jobs for current consumption that aren't competitive in a global environment. And so the President and the next Congress have to focus on making the economy competitive again. We have lost our ability to export competitively.
Kaufman: Before the President comes back in January and the legislative process begins, there is a continuing job for the Federal Reserve to continue the quantitative easing and be even more innovative. They have to do more. That will lower the cost of refinancing homes and encourage some private-sector lending which hasn't been taking place.

When the President comes in, in January, he has to indicate that there is a capital expenditure program being undertaken by the U.S. government that will improve our competitiveness, whether it is transportation, education, any of the other programs. And he has to put a dollar amount next to it so that we understand this is not permanent.
Calomiris: I don't have a to-do list for the President because the President is basically irrelevant in terms of leadership on this problem right now. The President is about to lose control of Congress, if he ever had it, and I think the real interesting to-do list is for the Republicans controlling Congress. Of greatest importance for them is to articulate a long-term vision of government, to articulate it in a way that is practical, that shows real leadership. And that will set up the transformation that has to come after 2012. My view is we are really not going to get out of this for many years.
Shiller: The most important thing right now, and I mentioned it already, is to do something about state and local governments. And I would propose that we do general revenue sharing. It has a Republican flavor to it because it is a proposal to decentralize, to get the expenditure decisions closer to the people, and to people who know what the local conditions are.
Orszag: I am a little hesitant to give my former boss a to-do list, but I think there are four things that need to happen. One is that both the congressional leadership and the Administration need to help provide a new sense of optimism, getting the [overheated] rhetoric down and having more confidence building.

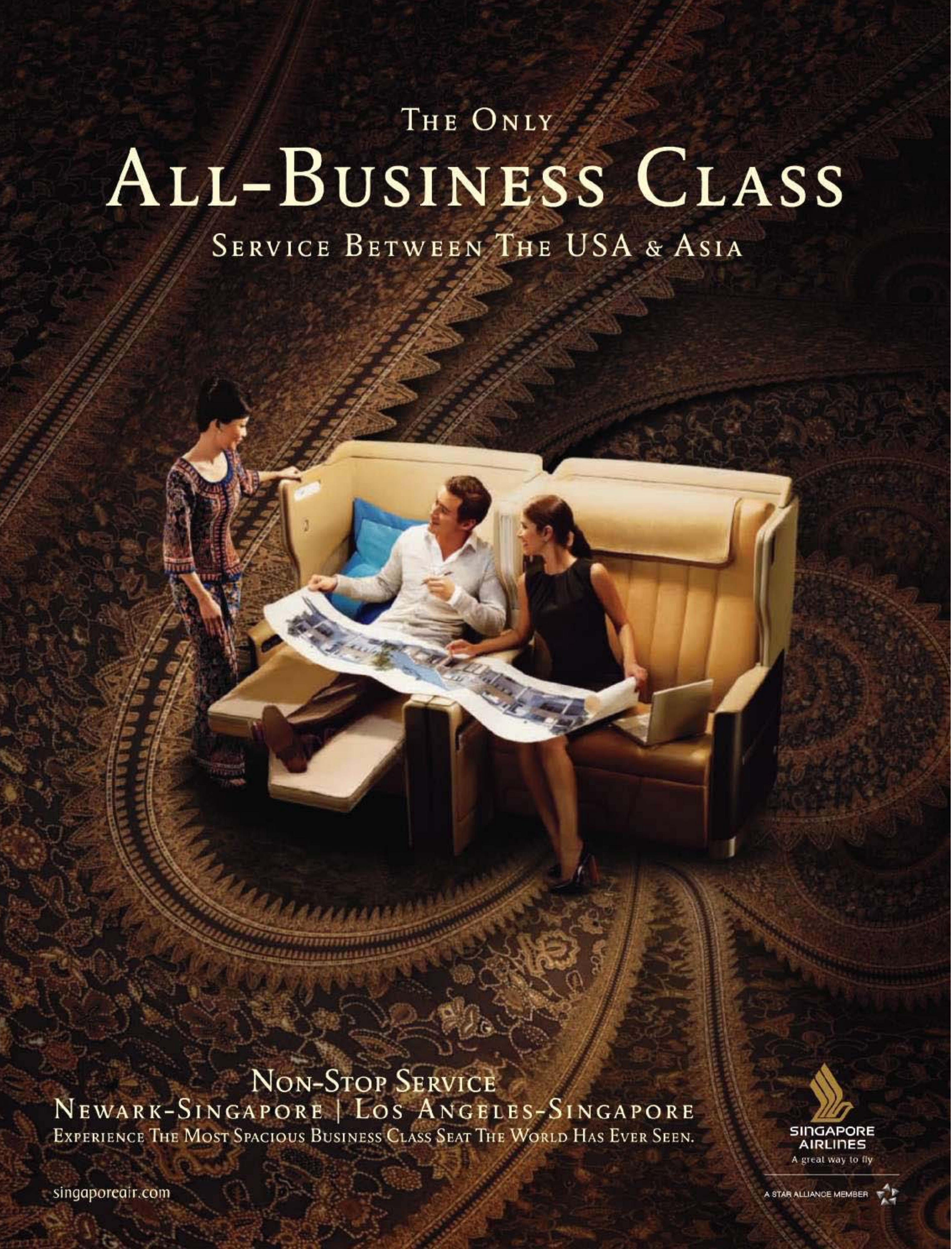
Second, an additional program. I would focus on an infrastructure bank. Third, we need to figure out what we are doing on the [Bush] tax cuts that are scheduled to expire at the end of this year. I have a proposal to extend, preferably, only the middle-class ones, but if need be, all of them for two years and then have them all disappear, which would largely solve our medium-term fiscal problem. And then, finally, we have huge implementation issues. You have got, especially in health and in the finance bill, lots of things that need to be gotten right. And just from an administrative perspective, focusing on execution on those important pieces of legislation is a 2011 issue. Ⓑ


Robert Shiller

People are very upset. They feel that the country is not theirs, that a small group of wealthy people who get bailed out and bribe the government are in charge.

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Can This Can Stay Cool? A Jet-Setting Family Takes



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Over a Blue Collar Brand. By Matt Schwartz. Photograph by Jamie Chung



On a July afternoon, Evan and Daren Metropoulos, the new owners of Pabst Brewing, showed up at the lounge on the 35th floor of the Mandarin Oriental in midtown Manhattan. They had come to discuss their plans for Pabst, which their father and co-owner, C. Dean Metropoulos, bought in May for about $250 million.

The Oriental does not serve Pabst Blue Ribbon, the company's flagship brew, so the brothers ordered a lemonade and an iced tea. A hotel like the Mandarin may seem an unlikely meeting place for the owners of a beer that has long traded on its working-class image—the Lutz Tavern, a dive in Portland, Ore., is more like it, where 16-ounce tallboys go for $1.75. But the Metropoulos brothers were very much at home. They were passing through on their way to a wedding in Rhinebeck, N.Y., of an old friend from Martha's Vineyard, Mass., where they have summered since they were boys. Evan, 29, divides his time between Miami Beach, Los Angeles, and New York City. Daren, 27, lives in Los Angeles, in Hugh Hefner's old residence, a 7,300-square-foot English manor house he recently bought for $18 million.

Evan, in a green polo shirt and gold necklace, has a generous build and gregarious manner. Ideas for the future of Pabst's portfolio of brands spilled out of him in an entrepreneurial stream of consciousness. Daren, who occasionally interrupted, was in a navy blazer and button-down shirt. He is narrower, quieter, and cleaner shaven than his effusive brother.

Evan had been thinking about Red White & Blue beer, one of the company's roughly two dozen defunct brands, which they hope to revive. "What if we made that the military beer?" asked Evan. "What if we gave a huge portion of the proceeds to military charities—a grassroots program with military families? Why shouldn't Red White & Blue be the absolute American beer for the American soldier? We'll bring, you know, the Rotary Club, the veterans—"

"To help collaborate and get involved," added Daren.

"To support our troops," Evan continued. "We could develop a whole beer brand around our troops. So that when you see Red White & Blue at your barbecue, you know that money's supporting people who have died for our country. Those are ways that Budweiser will never be able to relate to. They're not American, like us."

"This is an American company serving the American people," noted Daren.

Evan began to get worked up, saying: "If you knew that 25 percent of your proceeds from Red White & Blue Beer were going to support these charities, then shame on you for drinking Bud Light! What the hell are you drinking that for? To support some foreigners?"

The brothers went on to lay out the Metropoulos strategy—a series of grassroots campaigns targeting regional markets. Celebrities, musicians, and local festivals would figure prominently. Lone Star, their Texas label, might sponsor rodeo riders. Primo, a Hawaiian beer, might build relationships with big-wave surfers. These campaigns would be supported by their father's knack for winning over distributors, as well as new product and flavor launches to build out Pabst's portfolio of brands.

Not present that evening, but central to the plans, was their father, 64, a billionaire known as "Mr. Shelf Space" for his ability to boost the sales of supermarket brands. The senior Metropoulos started out with a feta cheese business in Vermont and has established a long record of turning around names like Bumble Bee Tuna, Perrier-Jouët, Chef Boyardee, Duncan Hines, Aunt Jemima, Vlasic Pickles, Swanson frozen dinners, and Ghirardelli Chocolate. He bought Pabst from the charitable trust of Paul Kalmanovitz, the company's late owner, acquiring a trove of musty American beer brands, among them Colt 45, Old Milwaukee, Primo, Rainier, Schaefer, Stroh's, Schlitz, Schmidt, Lone Star, National Bohemian, and the flagship, Pabst Blue Ribbon. The company, based in Woodbridge, Ill., has about 200 employees and more than 80 trademarks and 42 beer brands, fewer than half of which are active. The beers are brewed through a contract with MillerCoors, according to Pabst's specifications, many at factories once owned by Pabst.

With the acquisition, Metropoulos has taken control of a murderer's row of brand names—if it were 1973. Of the 10 best-selling U.S. beers that year, Metropoulos now owns the brand names for the second, third, sixth, seventh, and eighth slots: Schlitz, Pabst Blue Ribbon, Schaefer, Stroh's, and Falstaff, respectively. None is in the top 10 now. Metropoulos sees that as a tremendous asset. "Americans are beginning to be drawn to nostalgia," he says. "They want brands that they remember being identified with their community and region."

In most of his previous deals, Metropoulos entered into



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"We want to win. We want to blow these brands out, explode them, and make everyone lots of money."

partnerships with private equity firms and investment banks, and later sold out. With backing from the Texas-based buyout firm Hicks, Muse, Tate & Furst, Metropoulos bought International Home Foods in 1996 for $1.3 billion and sold it to ConAgra for nearly $3 billion in 2000. Along with J.P. Morgan and J.D. Childs, he bought Pinnacle Foods in 2003 and sold it to the Blackstone Group for $2.2 billion in 2007.

Pabst, says Metropoulos, is different. It's the first purchase Metropoulos has made without outside capital or an exit strategy. With Evan and Daren at the company's helm beside their father, the Metropouloses see Pabst as a platform for possible future acquisitions, and the foundation of the family's legacy.

"This is a trophy property," says Evan. "This is like an antique, unrestored Duesenberg, which we'll own for the rest of our lives."

If it is like an old car, Pabst Blue Ribbon has performed the Chitty Chitty Bang Bang-like trick of restoring itself, and the challenge for the Metropoulos family may be to stay out of the way and let the miracle keep happening. Over the past eight years, Pabst Blue Ribbon has reversed decades of slowing sales. After bottoming in 2001, sales of Pabst began to rebound, flattening out briefly in 2005, and then rising again with an increase of more than 20 percent in 2009.

The PBR renaissance can in part be traced to the marketing practices of its former owner, Kalmanovitz, who did no marketing at all. He oversaw a hostile takeover of the company in 1985 and quickly cut the company's advertising budget, bled the company of cash, and focused on developing the brewer's real estate. This led to a generation of beer drinkers who hadn't heard from Pabst, and who liked that. If they had any impression of Pabst, it came through the remembered refrigerators of their fathers and uncles, or Dennis Hopper's character in *Blue Velvet* expressing his strong preference for the brand. But it didn't come from the kind of messages that companies like Budweiser and Miller spent three decades slapping on every leasable surface. When the children of the late 1970s and early '80s reached legal drinking age, Pabst Blue Ribbon was waiting for them, a beer that offered the same inoffensive pilsner flavor as the mass-market brews but at a lower price, and without any marketing baggage.

"It was serendipity," says Kevin Kotecki, Pabst's chief executive. "There were a few wise people here who recognized the trend and started to slowly capitalize on it." Pabst marketers gave the brand a few careful nudges—like sponsoring bike messenger events and inviting artists to produce Pabst-related works. Gradually, with the brand's image being crafted not by the company but by its consumers, the beer spread into the hands of the hipsters who flock to neighborhoods like Williamsburg in Brooklyn and Silver Lake in Los Angeles. Along with Chuck Taylor sneakers and fixed-gear bicycles, Pabst became one of a handful of badges for a subculture that prides itself on its contempt for convention.

The Metropoulos brothers marvel at the beer's heritage. "A lot of blue-collar workers I've talked to say 'I've been drinking a six-pack of Pabst, every single day, seven days a week, for 25 years,'" says Evan.

"It's, like, habitual," says Daren. "It's part of their life. It's their lifestyle."

Unlike Kalmanovitz, the brothers take their marketing seriously. In the three months since the Metropouloses acquired Pabst, the brothers have personally brought the beer into more than 250 new restaurants, supermarkets, and bars. Among them is Avenue, a $2.5 million "gastrolounge" in the Chelsea neighborhood of Manhattan with a nearly impenetrable guest list. The brothers have Hollywood connections, and they are working them. There are talks with Snoop Dogg to get the rapper behind the launch of new Colt 45 flavors, which Evan described as "colorful, ripe, tasty, vibrant flavors that will incorporate 5 percent juice into the malt liquor."

"Snoop's mother drank Schlitz," Evan added. "He told me so himself!" In the coming months Funny or Die, the comedy website founded by Will Ferrell's production company, will begin producing sketches incorporating Pabst products. "The brothers' energy and positivity are just infectious," says Martin Lesak, an agent at Creative Artists Agency who helped put together the Funny or Die deal. "Evan said to us, 'We want to win. We want to blow these brands out, explode them, and make everyone lots of money.' I was down with that."

The Metropouloses are betting that the authenticity of the brand, when properly managed, can be scaled up and even exported. In China, a Pabst licensee already sells "Blue Ribbon 1844" for $44 per bottle, a special formulation using German caramel malts and aged in oak whiskey barrels. The Chinese vendor is emblematic of the Metropoulos ambition—to replicate the PBR resurgence and turn Pabst Brewing into the last grand old beer company owned by Americans and known worldwide.

Even as Pabst has grown over the past few years, consolidation in the beer industry has made it a comparatively smaller player. Two giants, Belgian ABInBev, which owns Anheuser-Busch, and London-based SABMiller, which operates MillerCoors as a joint venture with Molson Coors Brewing, control 80 percent of the $100 billion U.S. beer market. The two giants have had success pushing American-branded macrobrews overseas, but in the domestic market they've been losing

Six storage tanks in La Crosse, Ill., were painted to look like Old Style cans



Made appearances in *W*, Oliver Stone's biopic of the 43rd President

Pabst revived Hawaii's Primo in 2007

share to niche players. Among the new offerings are "malternatives," which include sweet drinks like Mike's Hard Lemonade and Smirnoff Ice; and ultra-premium craft brews from companies like Full Sail and Sierra Nevada. Craft brewing sales rose 12 percent during the first half of 2010, pointing to a seventh consecutive year of outpacing the beer industry as a whole.

This flight from mass-market beer is especially dire in the so-called premium segment–the heavily advertised macrobrews like Budweiser, Bud Light, Miller Genuine Draft, and Miller Lite. Sales of Budweiser fell nearly 10 percent between the second quarters of 2009 and 2010, and only four of the country's top 30 brands, PBR among them, are growing. Drinkers looking for quality are buying craft brews; those looking for a cheap buzz are switching to nearly identical "sub-premiums" like Busch, Keystone Light, and Pabst Blue Ribbon.

"For PBR, any market share growth is going to come from premium lights–Bud Light, Miller Lite, and Coors Light," says Harry Schuhmacher, publisher of *Beer Business Daily*. "Pabst's taste profile is similar–a light lager. It's in a sweet spot. It costs less, but you're not ashamed to bring a 12-pack to a party. Pabst is cheaper, but it still has cachet."

"They need to keep doing what they've been doing," said Anthony Bucalo, an analyst who covers the beer industry for Credit Suisse. "Keep the brands local, hip, and organic. They can't screw that up and lose the core hipster drinker that's brought Pabst so much success."

Keeping advertising below the radar could be essential to the brand's continued growth, says Ted Wright, who worked on the team that managed the Pabst resurgence. "PBR was authentic because they were broke," he says. "When you're a salesman and you don't have money, then ipso facto you are authentic. There's no radio, no TV, no guy up there saying 'Hey, kids, PBR is cool!'"

Pabst Blue Ribbon sales totaled $165 million in 2009, according to SymphonyIRI Group, 42 percent of Pabst Brewing's total revenue and enough to offset laggard brands in the stable, such as the No. 2 and 3 brands, Old Milwaukee (down 11.8 percent this year) and Colt 45 (down 2.7 percent). Total company sales growth was 4.7 percent. With Pabst Brewing accounting for less than two percent of the U.S. beer market as a whole, a tiny sip of Anheuser-Busch InBev's market share would mean huge gains for the Metropouloses.

On a conference call with all three family members a few weeks before the meeting at the Mandarin Oriental, Evan sounded eager for competition. "Failure is not an option," he said. "We're going to look at this as a war."

His father gently reprimanded his son, then set forth a softer approach. "The world is a big place," Metropoulos said. "We have a wonderful portfolio that has a place in the heart of Americans across the country. Now, it's all about nurturing."



Daren and Evan Metropoulos on June 18, 2010
at a family home in Beverly Hills

A few weeks later, father and sons drop by the Breslin Bar & Dining Room adjoining the Ace Hotel in New York, a restaurant resembling a vintage hunting lodge, with dark wood and nostalgic knickknacks. Evan bustles right over to the bartender and introduces himself. As Dean stands back and looks on approvingly, Evan pitches Pabst Blue Ribbon, Schlitz, and McSorley's, which Pabst markets on contract.

When the brothers were young, says Dean, they were nearly thrown out of an A&P on Martha's Vineyard for rearranging the tuna display. "But they own the company!" Dean told the manager, who finally agreed to let the boys move Bumble Bee to the front.

Evan trades cards with the bartender, then joins his father in a booth. Dean has senatorial hair and frank blue eyes. He is dressed impeccably in a gray suit with a fine check and a subtly patterned tie. He orders tea and shows off congratulatory e-mail for his purchase of Pabst. He notes that a young descendant of the Schaefer Beer dynasty sent along a copy of a family photo album with shots of the brand's old brewery on Fifth Avenue. The son of a friend told him about Pabst's following among Harvard students. "Every day I get these," says Dean. "People go wild. I've never had a brand talk to me like this."

One of the secrets to marketing, Dean says, is to "live the brands, to experience them, to feel them myself, and then make the consumer a part of that. Paying someone to say 'Oh, I'm P. Diddy and I'm drinking Perrier-Jouët'–that's not us. If we happen to know a celebrity and they happen to appreciate our brand, that's different. But it needs to be organic. Authentic."

As an example he cites Jeremy Shockey, another friend of the brothers. On the celebrity-tracking website TMZ.com there's footage of Shockey, a tight end for the New Orleans Saints, leaving a bar with the brothers, his arm over Daren's shoulder, wearing a PBR T-shirt and giving an impromptu tribute to the beer.

At the Breslin, Dean points out a sign hanging on the wall, a brass bull with glowing red eyes framed by the words "Schlitz Malt Liquor." Like Pabst, the sign had probably gathered dust for years before being recommissioned to authenticate the Breslin, which opened in 2009. "That's our bull," says Dean. "That's history." Ⓑ

METROPOULOS: VANESSA STUMP

Schlitz was the world's largest brewer in the first years of the 20th century



Seattle brew named after the 14,411-foot mountain

Flagship of Detroit-based Stroh's, sold to Pabst in 1999

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WHO YOU CALLING "WIFE OF"?

Yes, Lisa Falcone has a very rich hedge fund manager of a husband. But she's not going to let that stop her. By Alexandra Wolfe. Photograph by Martha Camarillo

Lisa Falcone is sitting at the head of a conference table, rapping to music by Swizz Beatz and waving her tanned arms above her head. She's meeting with the two employees of her fledgling company, Everest Entertainment. Just outside the room, her husband, Philip Falcone, is running his $9 billion hedge fund, Harbinger Capital, but that doesn't hold her back. She produced the song and sings along as it blasts from iPod speakers on the table: "Come on bitches, get your hands in the air, ugly bitches too, we don't care!" Harbinger analysts walking by barely look up at Lisa, 41, who is striking in a low-cut leather dress and a huge diamond cross pendant. They know she's the boss's wife. Harbinger's young, blond British receptionist brings a tray with a mug of green tea for Lisa, who likes to point out that the space is as much hers as her husband's. "This is *our* office," she says. "Eighteen years and no prenup means family office." She quickly adds that Everest will soon move to a new location away from Harbinger, revealing a dilemma that is central to Falcone's ambition: how to leverage her husband's connections and resources while differentiating herself as an entrepreneur in her own right.



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"This is all borrowed stuff. God kind of loans it to us, and somebody takes it afterward. Am I going to go to Heaven sitting on this couch?"



Philip, a former hockey-playing junk bond trader who founded Harbinger in 2001, made a fortune betting against subprime mortgages in 2007. His fund has since encountered rockier times, but that hasn't damped the Falcones' enthusiasm for lavish living. At the height of the financial crisis, when other billionaires were pulling back on ostentatious spending, the couple bought a $49 million townhouse that formerly belonged to *Penthouse* founder Bob Guccione and embarked on a series of high-profile philanthropic donations.

As eager as Falcone is to establish herself as a movie producer and patron of the arts, she relishes the role of an outsider. She comes from an underprivileged background and doesn't censor her behavior for anyone. By starting her own entertainment company, she has taken the traditional role of the Park Avenue spouse and turned it upside down, while also giving hope to independent filmmakers who have seen their opportunities dry up over the last few years. Falcone's venture has attracted Hollywood talent such as Annette Bening and Paul Giamatti, and Sony Pictures Classics and Fox Searchlight have agreed to distribute her first few movies. While she didn't have to go out and find investors to finance her projects like most independent producers, that doesn't mean she hasn't worked to get where she is. "Obviously, my husband's made the money, but we've been together 18 years, and the person behind the person isn't usually seen," she says. "So the money I'm using I've earned."

It was through the New York City charitable circuit that Falcone first made herself known to the world. In 2007 she appeared at the American Friends of Versailles tour in Paris, where tickets cost as much as $50,000 per couple. She was wearing a backless, white-and-purple gown with a matching hairpiece and arrived on the arm of a Filipino stylist named Zaldy Goco. Then, in 2009 she leaped—literally—into the public consciousness by grabbing the microphone in the middle of a speech by Joshua David, the co-founder of a charity that raises funds for New York's High Line park, and announcing a spontaneous $10 million donation. She later held the after-party for Everest's first production, *Mother and Child*, at the High Line, where she danced onstage with Kerry Washington and Alicia Keys. She also joined the board of trustees of the New York City Ballet. "She's something of an enigma," says New York Social Dairy editor David Patrick Columbia. "She looks out of place at all these things but she puts herself out there. She's a stranger in her own land."

Before they started the renovation of the Guccione mansion, expected to cost $10 million, the Falcones hosted an elaborate third birthday party there for their twin daughters, Carolina and Liliana. Lisa had muralists paint the walls with *The Wizard of Oz* scenes and sent out hand-calligraphed invitations, according to two guests. Little people wore uniforms monogrammed with her daughters' initials in green rhinestones. (The Falcones are living in the townhouse next door, which they also own, during the renovation.)

One afternoon early this summer, Falcone lounged on a plush daybed in her Versailles-inspired drawing room. She smoothed down her Balenciaga minidress and lifted a toned leg, braced in a cast, up onto the couch. She had recently fallen off a Vespa that her husband had given her. "I thought it worked like a regular bike," she laments, "but it had a motor."

When the couple bought the mansion, it looked exactly like a place you'd expect the *Penthouse* mogul to live in—a piece of Las Vegas transplanted to Manhattan. Now Falcone says she's trying to restore it to its pre-Guccione elegance. "It's actually not the Guccione Mansion, but the Milbank House," says Falcone. "[Jeremiah Milbank] had two daughters who loved to swim, then Guccione bought it and turned it into a 1980s Caligula."

Either way, it's a long way from Spanish Harlem, where Lisa Velasquez was born and raised, as she tells it, by a "rageaholic" single mother on welfare. "It was like walking on broken glass," she says, describing her childhood. "You don't even want to make noise on that broken glass."

She is reluctant to discuss her upbringing in detail—she won't disclose where she went to high school, for example—but says she learned through the experience to seek out the positive aspects of any situation. "People with challenging backgrounds are the most optimistic, I heard," she says. Her father, whom she saw intermittently growing up, "was the best busboy in the world." She still has a slight Puerto Rican accent, the legacy of her immigrant parents. "I'm proud of my background," she says. "I'm not changing, and I'm not getting a speech coach. I do what I want to do, and I wear what I want to wear."

She met Falcone at Canastel's restaurant on Park Avenue South, now Angelo & Maxie's Steakhouse, when he was a young junk bond trader. She was working as a model and happened to be sitting with some friends who knew Falcone. He came over and sat with them, and five years later, in 1992, Philip and Lisa married.

Philip, 48, grew up in small-town Minnesota, where his father was a utilities superintendent and his mother worked in a shirt factory. He took the first plane ride of his life when he visited Harvard University as a hockey recruit. After graduating from Harvard in 1984, he tried playing professionally until an injury ended his sports career and forced him into a more practical line of work. He joined Kidder Peabody as a bond trader. Early on, according to Lisa, the couple had little income and slept on an air mattress in a tiny studio apartment. That soon changed. Philip became increasingly successful and eventually launched Harbinger Capital. In 2007 he made a spectacular bet against the real estate bubble and amassed an estimated $2 billion fortune.

At its peak in 2008, Harbinger managed $26 billion. It is down to about a third of that after client losses and withdrawals. For the past four years Falcone has been trying to build a high-speed wireless network, and at least 40 percent of Harbinger's assets are tied up in the wireless spectrum wager. Falcone has committed to the Federal Communications Commission to build a network that will cover 100 million people by 2012 as part of the agreement to hold the wireless license. Investors have complained that such a large, illiquid bet is not appropriate for a hedge fund. Harbinger's main fund is down approximately 14 percent so far this year, while rival funds have returned about 5 percent, on average.

"I'm proud of my background," Falcone says. "I'm not changing, and I'm not getting a speech coach. I do what I want to do, and I wear what I want to wear."

It was on Philip's suggestion that Lisa started Everest Entertainment in 2008. "People would have scripts and

FROM LEFT: NICK HUNT/SIPA PRESS; MARIO TAMA/GETTY IMAGES; NICK HUNT/SIPA PRESS; MATT SUKKAR/SIPA PRESS

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Lisa and Philip at a 2009 New York City Ballet benefit
The "1980s Caligula" Guccione Mansion
Frolicking with Alicia Keys
Lisa and friends screening *Mother and Child* at Sundance






say, 'Take a look at this,' and I would tweak them and fine-tune them," Falcone says. "Then my husband said, 'You should get into this business.'"

While she doesn't have a film background, Falcone says she loves movies: "I was always trying to figure out the ending before the beginning and pretty much was always right." She grew up watching *Gone with the Wind* over and over and would ask herself, "How did they do that?" She didn't get a chance to explore her interest until decades later. "It wasn't like my parents were like, 'let's get her a video camera' like Steven Spielberg's did," she says.

With $5 million in family funds as the initial budget for her first project, Falcone decided to focus on independent movies she could relate to. After seeing the critically acclaimed *Precious*, about a girl's ordeal in the projects of New York that reminded Falcone of her own childhood, she hired one of its executive producers, Tom Heller, as her business partner. When Rodrigo Garcia, who directed *Nine Lives* and *Passengers*, sent her a script about an orphan called *Mother and Child* that he'd been shopping around for a decade, Falcone decided to produce it. She still had an upward climb. "I had one person who has been in this business a very long time saying, 'Don't do this movie,' " she remembers. "But I'm like, 'I'm doing this movie.'"

Annette Bening and Naomi Watts were persuaded to play the title roles, and in 2009 the movie made its debut at the Toronto International Film Festival, where Sony Pictures Classics bought the rights to distribute it. It was later shown at the Sundance Film Festival. Falcone says the man who had questioned her decision to make the movie in the first place approached her after the first screening. "He apologizes a hundred times and is like, 'Wow, what a vision,' " she says. "He said it was like threading a thin needle." She has since established a reputation as a reliable, if eccentric, source of funding for quirky movies. "Even if people have unlimited resources, how many times do you just see vanity projects where they do generic work?" says Geoffrey Gilmore, chief creative officer of Tribeca Enterprises, which runs the Tribeca Film Festival. He says her latest movie, *127 Hours*, "isn't necessarily a slam dunk of a story, but at the end of the day she's making choices about films that are complicated, that take risks, and at the same time that I think are going to play."

Early in 2009, Everest hired a third executive, Gareth Smith, formerly a vice-president at the luxury concierge service Quintessentially. They now have two movies in the works. *Win Win*—written and directed by Thomas McCarthy, who also directed the Oscar-nominated independent film *The Visitor*—stars Paul Giamatti and Amy Ryan. The other, *127 Hours*, features James Franco and was shown at the Toronto festival this month. Fox Searchlight will distribute both. "Given Lisa's position financially, she doesn't need to make money off of this, and the film company doesn't need to make money," says Smith. Instead, a percentage of their profits will be donated to a charity relevant to each film's content, and the rest will be reinvested in the next project.

Falcone says she's committed to producing artistic movies rather than blockbusters. "It has to be something where you can leave the theater and say, 'Holy ___, I can relate to that,' whether it's a happy story or it made you cry."

Back in the Harbinger conference room, she tries to play the trailer for *127 Hours* on her iPad, to no avail. "Why won't this open?" she asks as she pokes the screen, bending over with the orange silk of her dress spilling over the papers on the table. "Can someone figure this out?"

When she isn't busy making films, renovating, or giving to charity, Falcone says she spends most of her time with her daughters. On a typical day she wakes up at 4 a.m., eats breakfast, goes to the gym for an hour, makes coffee for her husband, and takes her girls to school. She then works for four hours on her own projects, listening to new music tracks she's thinking about producing and making notes on film dailies. She picks her daughters up from school and takes them to their afternoon activities or to Central Park. Falcone is philosophical about the world she now inhabits. "I've taught my daughters to stop and smell the roses," she says. She glances around her living room. "This is all borrowed stuff," she says. "God kind of loans it to us, and somebody takes it afterward. Am I going to go to Heaven sitting on this couch?" she asks. "Do I take my house with me? No."

With the success of her first movie, Falcone is confident that her next big push, into the pop music business where she plans to collaborate with artists such as Mary J. Blige, Keys, and Jay-Z, will be equally rewarding. "I have a very good ear," she says. "But God gave me something that I'm better at than anyone else. And that's being me." Ⓑ



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The End of the Office Affair?

Facing mounting legal threats, the office romance may become the latest victim of the recession.

By Spencer Morgan

Photograph by Darren Braun

Etc. The Office Romance

In 2002, Wal-Mart Stores dispatched an investigator to Guatemala City on a top secret assignment: to spy on factory inspection manager James W. Lynn as he toured a facility with a female colleague. During four days of surveillance, the investigator eventually uncovered the evidence he was after in the form of "moans and sighs" emanating from their Holiday Inn bedroom. In accordance with Wal-Mart's rigid "no-fraternization" policy, Lynn was fired.

The time-honored institution known as the office romance has survived threats like corporate no-fraternization policies, philandering chief executives, and David Letterman. (Or, in the recent case of former Hewlett-Packard CEO Mark Hurd, ambiguous contractors.) Now there's a new legal menace: scorned workers who claim that an office affair fostered an invidious work environment, even if they weren't actually involved in the romance themselves. So-called third party or hostile work environment sexual harassment claims are difficult to prove but easy to allege, particularly by employees fearing for their jobs in a sluggish economy.

As job insecurity has mounted and third party claims have risen, the office fling may become the recession's latest victim. "It seems likely that there's a certain opportunistic element to what's happening out there," says Sondra Solovay, a director of Workplace Answers, a San Francisco-based compliance services company. "Employees who fear for their jobs are making sexual favoritism complaints as a means of ensuring their own job security."

The most pressing threat to the office romance, Solovay says, is the rise of the retaliation lawsuit. Such suits are waged by workers who claim they were fired to prevent them from filing a discrimination claim against their employer. Currently, retaliation suits are contributing to a wave of litigation that has employers in a panic. The Equal Employment Opportunity Commission's records show claims involving retaliation grew by 23 percent in 2008–roughly twice the rate of all other claims. They totaled 32,690 and accounted for approximately one-third of claims filed with the agency. Retaliation claims rose again last year, accounting for 36 percent of the total. The EEOC, whose mandate is to enforce federal antidiscrimination laws, has added 170 investigators across the country, in part to address the issue.

A once-amorous workforce already seems to be feeling the effects. This February, 75 percent of U.S. workers surveyed by job search website Monster.com believed a workplace relationship could bring a conflict. Sixty-two percent said they felt office romances were a distraction from job performance. Careerbuilder.com's annual Valentine's Day romance poll has shown an alarming decline in reported office trysts. In 2006, 50 percent of respondents claimed to have partaken in a workplace relationship during their career. Earlier this year, the number dropped to 37 percent.

In a sluggish job market, employees see sexual harassment complaints as a way to further job security

This is disturbing news not only for employees but also for their bosses. Some management experts believe that a workplace fling can "greatly increase something called 'engagement,'" says Stephanie Losee, co-author of *Office Mate*, a guide to finding love in the workplace. "That's when you're excited to come in and work and you care about your company." For these reasons, National Public Radio, Princeton Review, Pixar, and Southwest Airlines encourage in-house matchmaking. Frederick S. Lane III, author of *The Naked Employee*, argues that co-worker couples spend more time at work, take fewer sick days, and are less likely to quit.

More than ever, all it takes is one overly amorous apple to ruin the fun for everyone. Claims of such behavior led to the landmark office romance legal ruling–*Miller vs. Dept. of Corrections*, in 2005–involving a story of a classic prison love triangle. Plaintiffs Edna Miller and Frances Mackey, both corrections officers, claimed they were discrimination victims of Chief Deputy Warden Lewis Kuykendall, who allegedly was sleeping with three of their colleagues. Miller and Mackey alleged that Kuykendall habitually rewarded the three women with promotions, bonuses, and other special treatment. On one occasion, they said, a paramour announced that if she didn't get promoted, she would take the warden down with her knowledge of "every scar on his body."

Worse, Miller and Mackey described a prison rife with awkward tension, lovers' quarrels, and public displays of affection. When Miller told Kuykendall about an affair one of his girlfriends was having with



Jim and Pam (on *The Office*) exemplify the virtues of a workplace romance

BYRON J. COHEN/NBC/EVERETT COLLECTION

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another female employee, she said, the message was passed on to the paramour, who summarily beat Miller into submission and locked her in a closet.

In its ruling, the California Supreme Court declared that neither Miller nor Mackey were victims of traditional sexual harassment. However, it concluded, their claims implied they suffered the collateral damage of an office romance, even though they weren't intimately involved. The case subsequently redefined sexual discrimination liability—and the intervening years have only seen the law evolve more.

Third party discrimination claims have helped further the rise in retaliation and develop the legal theory of "Sex Plus." Regarding the latter, courts have ruled that when a romance enters the office, an employee can prove discrimination based on gender "plus" another particular characteristic. If a manager's failed office romance forces him or her to focus more heavily on the work, his increasing demands on, for example, a pregnant underling could give her the grounds for a lawsuit. Under Sex Plus, the pregnant woman could allege that the office romance had provided an underlying basis for a separate act of discrimination. "When the courts find in favor of the client, then interpretation of the law gets expanded," says Dr. John A. Pearce II, an endowed chairman at Villanova School of Business. "We're seeing the emergence of more and more third party cases. Attorneys go to court and say, 'Following the logic of these laws, we think that you ought to find in favor of our client in this particular new twist.' And that's exactly what's happened."

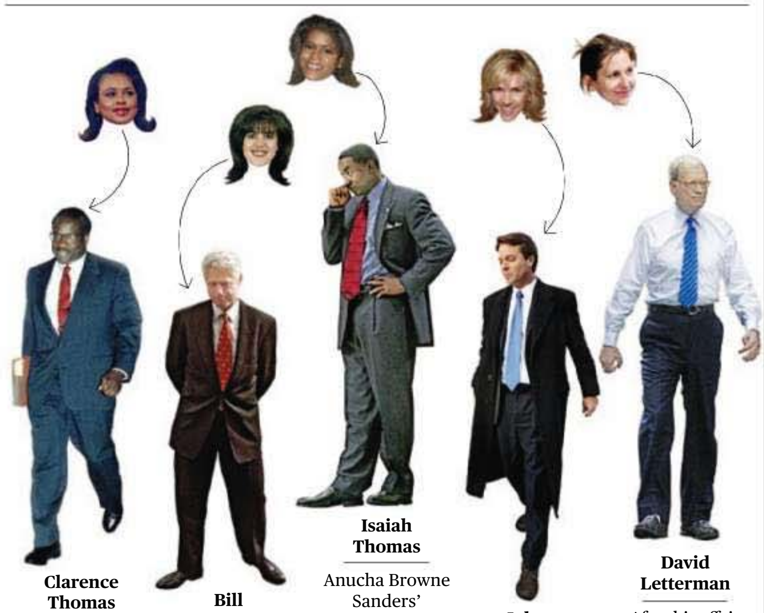
According to the EEOC, money paid out by companies in sexual harassment lawsuits has averaged only $47.8 million over the last 12 years. That low figure, many believe, is indicative of employers' preference to settle out of court rather than face an ugly lawsuit. However, thanks to the rise of third party discrimination claims, the EEOC recovered $376 million on behalf of discrimination victims in 2009.

Fearing such settlements amid a recession, a growing number of companies are fighting back. One popular method is forcing employees to sit through Web-based compliance training sessions that underscore the perils of a little affection in the copy room. By consolidating sensitivity seminars and policy education into a mandatory online tutorial, companies can put the onus of awareness on the employee. "The dollar amounts that companies are spending on training in general are significantly down from the 2007 and 2008 period," says Gary Fusco, a senior director at Workplace Answers. "But [one of] the two areas where companies actually grew in terms of real dollars targeted was compliance."

Another strategy is forcing employees to sign "love contracts," the office version of a prenup, stating their mutual affection will not interfere with the workplace. If such documentation effectively takes the fun out of an office romance, well, that's the point.

Honey, I'll Be Late Again

Philandering public figures have tended to give the office romance a bad name. Some have rebounded better than others.



Clarence Thomas
Anita Hill's accusations didn't keep Thomas from the Supreme Court

Bill Clinton
Clinton survived an "improper" relationship with intern Monica Lewinsky

Isaiah Thomas
Anucha Browne Sanders' allegations cost Madison Square Garden $11.5 million

John Edwards
A relationship with videographer Rielle Hunter ended his marriage

David Letterman
After his affair with Stephanie Birkitt was uncovered, Letterman's ratings jumped

FROM LEFT: STEPHEN JAFFE/AFP/GETTY IMAGES; GETTY IMAGES; BARRY THUMMA/AP PHOTO; GETTY IMAGES; BRYAN BEDDER/GETTY IMAGES FOR WSF; CHRIS TROTMAN/GETTY IMAGES; PATRICKMCMULLAN.COM; MARIO TAMA/GETTY IMAGES; SNITCHERDESK.COM/SPLASH NEWS; DENNIS VAN TINE /RETNA LTD./CORBIS

One landmark ruling centered on a prison rife with lovers' quarrels, awkward tension, and public displays of affection

Most companies, however, haven't yet decided what to do. According to a survey of more than 600 companies by the Society for Human Resource Management, 13 percent reported having a written policy addressing intra-office affairs; 14 percent claimed they had an unwritten one. "Companies are still on the fence," says Fusco. "They want to see what happens next before making their move."

One such company is discount retailer Costco. A recent issue of its monthly magazine, *The Costco Connection*, featured a photo of two co-workers locking lips over a queue divider under the banner headline, "Should dating co-workers sign a 'love contract'?" The *Connection* offered a panel of experts to inform the debate. "At issue here is whether an organization should invite a host of organizational vulnerabilities so as not to impede an office romance," noted Francie Dalton, one of the featured "experts from the field" and founder of Maryland-based management consultancy Dalton Alliances. "That it may happen anyway is not sufficient to negate the need for clear policy. ... This isn't being hard-hearted—it's acting to avoid ill-advised risk." B

The New Pod Squad

The latest iPods prove smaller is better. The cameras and touchscreens ain't bad, either. *By Arik Hesseldahl*

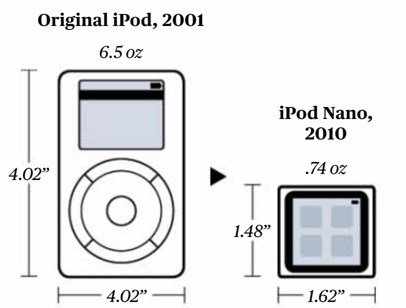
Other than Brett Favre mulling his future, the late summer ritual of the past decade has been Apple's release of its latest iPods. In nine years it has sold 275 million of the gadgets worldwide and reordered the music industry around its axis.

At the end of a busy year in which the company launched the iPad and significantly redesigned the iPhone, the new iPod Touch, Nano, and Shuffle are all improved and redesigned. More impressively, they represent our own evolution as consumers. Whereas the first-generation iPods catered to graduates of Sony Discmen, the newest iterations have been developed for sophisticated users who view iPhone technology and design as a right, not a privilege.

Of the three new models, the **Nano** ($149, 8 gigabytes; $179, 16GB) has undergone the most significant overhaul. Apple doesn't break down sales by model, but it has historically described the Nano as the most popular iPod. While the original models relied on hard drives to store music, the Nano, which made its debut in 2005, was an early user of flash memory chips, making it smaller and lighter than the iPod Mini.

Over the years it's only gotten smaller: Once about the size of a Chiclets box, the new Nano is, at less than 2.5 square inches, about as big as a book of matches. Apple has eschewed the wheel in favor of an iPhone-esque 1.54-inch touch-sensitive screen with diminutive onscreen buttons that are remarkably easy to manipulate. Album art looks surprisingly clear on the tiny screen, though cover text can be hard to read. Tapping the "playlists" button brings up a selection of iTunes music queues, while swiping your finger across the display from left to right will take you to different options such as FM radio, the photo viewer, and a pedometer that tracks your run. With two fingers you can rotate the display image to suit the player's position.

THE SHRINKING IPOD



Unlike its last three iterations, the new Nano doesn't play video. Although Apple rarely reduces its products' capabilities, it did so in this instance with good reason. The Nano's screen size was unsuitable for watching iTunes TV shows. This is a music-only gadget.

TV is where the **iPod Touch** ($229, 8GB; $299, 32GB; $399, 64GB)—the device you buy if you want an iPhone but don't want to pay a monthly wireless phone contract—comes in. Apple has significantly improved its hardware, bringing it more closely in line with the iPhone 4: It has the same high-quality Retina Display, muscular A4 processor, and front- and rear-facing cameras.

The Touch also supports the exceedingly cool FaceTime videoconferencing feature. As of Sept. 8, when Apple released an update to the iPhone's operating system software, Touch owners can partake in FaceTime sessions with iPhone owners. Yes, there are videoconference products, like Skype, but none are as easy to use as FaceTime: You press a button in the address book entry of the person you want to call, and you can start a face-to-face video chat over Wi-Fi. One day this will become the new normal.

The Touch's other software improvements are similarly drastic. Applications pop open faster and look better on the enhanced screen. IBook and Kindle libraries are perfectly readable on 3.5 inches. The front-facing microphone also makes apps like Shazam—which identifies music—fully functional. While the camera takes fine still pictures, its high-definition video capabilities are truly impressive in terms of both clarity and sound quality. Battery capacity has improved, too.

The third and least expensive member of the iPod family is the **Shuffle**, now in its fourth generation ($49, 2GB). After eliminating all buttons from its last version, Apple has reinstated the circular control wheel from the device's second-generation model. (The controls on the last Shuffle were on its headphones.) VoiceOver, the digital voice that announces song titles and playlist names, remains and works as well as ever. The Shuffle holds about 500 songs in a package the size of a cough drop and remains a value at less than 50 bucks.

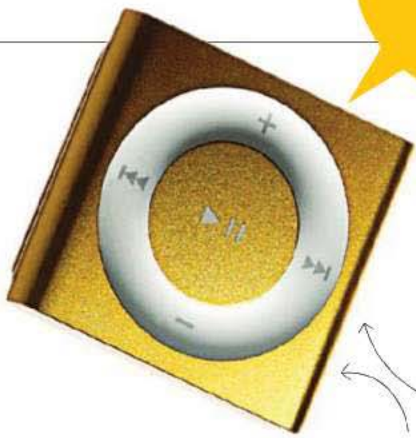
As a coda, Apple has also broadened its music ecosystem with iTunes 10, which boasts a new social networking feature called Ping. While an inspired notion, it's the sole release that misses the mark. Even though Facebook and Twitter devotees love sharing songs from their music libraries, many aren't lusting for another social network to follow their friends. Next September, perhaps Apple will have found a way to improve sharing on existing social networks. That might give us something to talk about as Favre ponders his future. B

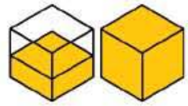
PHOTOGRAPH BY ZACHARY ZAVISLAK FOR BLOOMBERG BUSINESSWEEK

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The fourth-generation Shuffle ($49, 2GB) features buttons missing from its previous version





The new Shuffle is more than 50 percent smaller than the first-generation product yet holds twice as many songs

The Shuffle uses audible technology called VoiceOver that stands in for a display



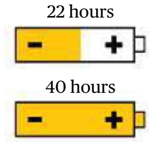
The Touch allows users to take part in FaceTime sessions over a Wi-Fi connection

The Retina Display is the same as the iPhone's

The Touch ($229, 8GB; $299, 32GB; $399, 64GB) is built with front- and rear-facing cameras



Less than a third of an inch thick, the Touch is 9.7 percent thinner than its predecessors



The new Touch can play 40 hours of music, compared with the 22 hours the first-generation version could play

The Touch includes a high-definition video camera

The new Nano ($149, 8GB; $179, 16GB) has a 1.54-inch touch-sensitive display

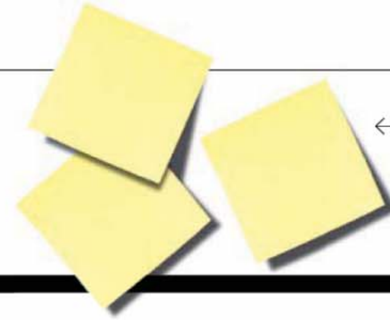
The new Nano's clock face can be made into a watch by clipping it to a band



The Nano has four times the capacity of the first iteration



Etc. Wealth



The Hidden Value In Multinationals

Daniel O'Keefe of Artisan Global Value Fund says multinational blue chips are cheap

Right now, you can buy dominant, globally competitive, well-capitalized businesses at absolutely cheap valuations. People are dumping the best companies and buying bonds because they're worried the U.S. economy won't grow. The bad news is already largely priced into these stocks, and value is hiding in plain sight. You can buy Johnson & Johnson at a price multiple of 8.5 times cash flow—a ridiculous valuation for one of the best companies in the world with a great balance sheet, great management, and a diversified business. You also can buy Wal-Mart at 12 times its earnings. Historically, such bargains have been much harder to find in large globally competitive companies.

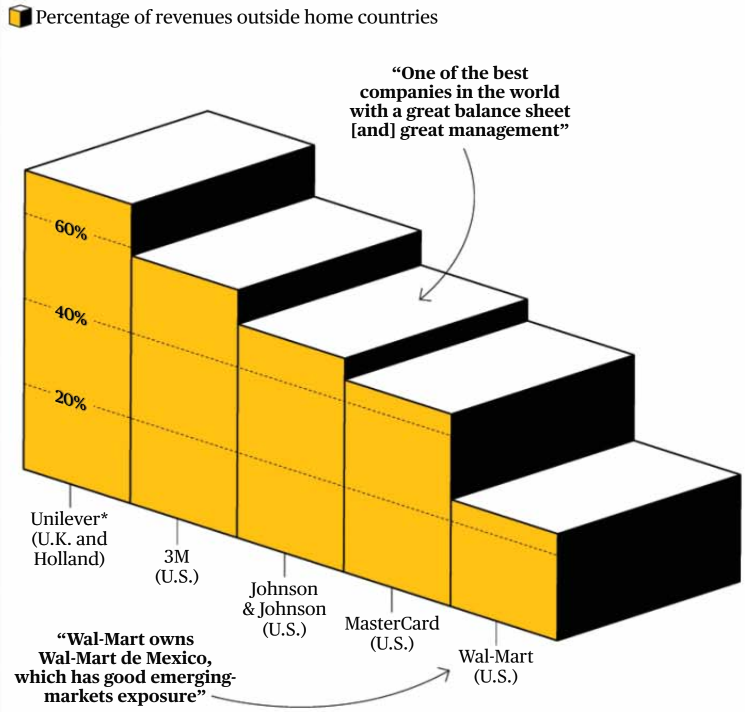
If you looked at our portfolio, it would seem like we're overweighting U.S. stocks. It's not that we're particularly enthusiastic about the U.S.; we're just enthusiastic about equities we're finding there. Many have no more exposure to the U.S. economy than European companies we own. They simply happen to be based in the U.S.

Where a company's stock is listed is largely not meaningful from an economic standpoint. People think it is, and that misperception creates bargains. Take Novartis, a company we own. It's a global pharmaceutical company based in Europe, but its geographical distribution of profits is not much different than that of a Johnson & Johnson or a Becton Dickinson, which are based in the U.S. We also recently bought MasterCard. Concerns about its business in the U.S.—and U.S. equities in general—have driven it to a very cheap price of about 8 times its cash flow. Most of its revenues and profits, however, come from outside the U.S.

It's true that there's more economic growth in emerging markets, but that growth doesn't necessarily equal investment opportunity. It's cheaper to get exposure to emerging markets by owning multinationals based outside of them, and I have plenty of exposure to them this way. One of our larger positions is Unilever. It's based in the U.K. and the Netherlands, but emerging markets account for 50 percent of its business. If its emerging-markets businesses were listed in their local markets, they would be selling for 30 times earnings; but now

STRAYING FAR FROM HOME

O'Keefe's portfolio may seem heavy on U.S. companies, but many earn a lot outside their home market



*DOES NOT BREAK OUT U.K. REVENUE DATA: BLOOMBERG; AS OF JAN. 2010 FOR WAL-MART, DEC. 2009 FOR OTHERS

People are dumping the best companies and buying bonds.... Value is hiding in plain sight

you can buy Unilever for 13 times earnings. 3M is another company we own that has significant exposure to emerging markets, as do Procter & Gamble and Wal-Mart.

The economic environment is highly uncertain, and that is why you can buy great businesses at the valuations that you are able to today. The math can significantly work in your favor over the next few years, even in a no-growth environment. When things are uncertain and people are fearful, you have to take advantage. You are not going to get a bargain when people think equities are the greatest thing since sliced bread. B *—As told to Lewis Braham*

The Stats: Daniel O'Keefe is lead portfolio manager of the $33 million Artisan Global Value Fund, which opened in December 2007. He also co-manages the $2.8 billion Artisan International Value Fund, which has beaten nearly 90% of its peers in the past five years. In 2008, Morningstar named him and co-manager David Samra fund managers of the year for their work at the International Value Fund.

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Etc. Next Life

Veering Off-Road After Wall Street

Whitehead's clients race through Nevada ghost towns on access roads and old wagon trails



David Whitehead left the Street to launch an adventure driving business in Nevada

"Have you ever seen *Mad Men*?" asks David Whitehead. "It was like that," he says of his 20 years on Wall Street. "The girls, the drinking. I look back and wonder how I survived."

For two decades, Whitehead, 45, traded aluminum and minor metals–titanium, manganese, magnesium–for various companies and his own account. In 2003, he invested in a titanium recycling company, called Jamegy, that he restructured and sold in 2006 for a profit. Nagged by the feeling that his days of big scores were coming to an end, Whitehead cashed out at 41 and moved to Las Vegas, to be in the Western deserts where he grew up.

While in Vegas, Whitehead rediscovered his childhood pastime of off-road dirt-bike racing. After helping friends launch an off-road motorcycle tour business in 2007, he saw the potential in Nevada for off-road adventure excursions on four wheels. The problem was finding cars tough enough for the trails.

His curiosity led him to California-based adventure-travel company Wide Open Baja, which has run cars in the famous Baja 1000 race for over a decade. Wide Open had everything Whitehead needed: a fleet of cars, a known brand, and a marketing operation. In 2009, Whitehead began negotiating a deal to license the Wide Open name and have them handle sales for his startup. He also spent $1 million of his own money to buy 11 open-cockpit off-road race cars.

Whitehead spent another $1 million on support vehicles, spare parts, chow wagons, and desert accommodations for tourists. After a year of negotiating with Nevada's Bureau of Land Management over permits, Whitehead says he agreed to pay the agency three percent of his gross. He also assumed responsibility for maintaining the trails he uses, which eats up another two to three percent.

In January, Wide Open Nevada opened for business offering two- to six-day packages. In the past nine months, 100 customers have paid about $2,000 a day for tours crisscrossing the public land north of Area 51. "My typical customer is bored stiff of going on golf weekends with the guys," says Whitehead, "I send them home with something to talk about." Ⓑ —*Adam Fisher*

Helmets supplied by Wide Open come with their own filtered air system



PEDALLING THE METAL

$7,000 Approximate cost of a four-day tour through Nevada's ghost towns and rangeland	**$6,000** The typical cost of repairing an off-road vehicle after a customer rolls it
500 Number of miles covered in a typical driving tour with Wide Open Nevada	**175** Horsepower of the engine in an open-cockpit, off-road Baja 1000 race car

DATA: WIDE OPEN NEVADA

PHOTOGRAPHS BY BRYCE DUFFY FOR BLOOMBERG BUSINESSWEEK

Chef Kevan Vetter experiments with recipes inspired by his 2010 holiday forecast flavors



The Spiceman Cometh

Flavor guru Kevan Vetter influences the taste of many fine foods—like Doritos. *By David Sax*

When Keira Knightley wears a dress on the red carpet, department store buyers take note and place orders. In the culinary world, her equal is a pudgy, middle-aged former hotel chef from Baltimore. In lieu of a trend-defining gown, Kevan Vetter, the executive chef at seasoning giant McCormick & Co., rolls out the company's annual Flavor Forecast—a range of flavor pairings that McCormick expects will resonate with American taste buds and drive sales.

Over the past decade, Vetter's chosen flavors have found their way into nearly every corner of the processed food chain, including Spicy Sweet Chili Doritos, Kashi Lemongrass Coconut Chicken frozen dinners, and Taco Bell's carne asada chalupa. His 2010 Flavor Forecast, published earlier this month, is the first ever specifically designed for the holiday season.

Vetter's flavors have made their way into the Colonel's Kentucky Grilled Chicken



Vetter, 43, is less Alice Waters than Dave Thomas. After honing his understanding of the American palate at suburban restaurants, he landed at McCormick in 1998 with the goal of enhancing its influence outside the supermarket. In his first Flavor Forecast, in 2000, he noted the rise of Latin American dishes and small plates. Melding the middle-brow culinary zeitgeist with the American palate's increasing quirkiness, he recommended five generic spices—cinnamon, cumin, ginger, dill, and fennel. "What was big was using sweet spices in main dishes, and savory spices in desserts," recalls Vetter. "We were supporting trends with flavors we felt made sense." New reports were issued in 2003 (championing an unheralded jalapeño called chipotle) and 2005 (which helped revive red curry), and every subsequent year. In 2007, Vetter moved beyond mere spice predictions to actual flavor pairings.

Vetter's flavors have a meaningful effect on McCormick's bottom line. "Within a matter of a couple of months, we'll get orders [for spices and flavors]," says Alan Wilson, chairman, president, and chief executive officer of McCormick. The company's share price has more than doubled in the decade since the 2000 forecast. Since 2005 between 13 and

TOP: PHOTOGRAPH BY ANDREW CUTRARO FOR BLOOMBERG BUSINESSWEEK

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18 percent of nonretail sales have come from new products launched in the three preceding years. Some of Chef Vetter's choice flavors have even enjoyed Lady Gaga-like stardom. After it was included in the 2006 report, sales of smoked paprika have grown 300%, leading to an entire line of toasted and roasted spices. Chipotle sales are up 75% in the past five years. "Eight years ago people couldn't pronounce chipotle!" says Vetter. Now, "it's on every menu from fast food to fine dining."

To perfect his forecast, Vetter spends six months brainstorming with a team of food scientists and marketers. They solicit suggestions from fine-dining chefs like David Chang of New York's Momofuku, and pay close attention to economic factors. (Could a statistical increase in sales of Ball jars suggest Americans are ready for more exposure to pickling spices?) Eventually the hundreds of possible combinations are whittled down to about 20 before the inevitable question—"Will this actually sell?"—is considered.

The answer isn't always easy. Last year's forecast called for pairing toasted sesame and root beer, and cayenne and tart cherry, among others. It's still too early to judge the success of these in the marketplace, but at least one prominent chef was nonplussed. "I remember reading [the final report] and thinking 'Oh, those are combinations I'd never use,'" says Chang. "It made very little impression on me."

McCormick, however, is less interested in impressing top chefs than in influencing the flavor of Cheetos that Americans will buy in five years. After the flavors are finalized, McCormick's marketers present the results to more than 100 clients while distributors give presentations to hundreds more. Each talk is tailored to the clients' interests, and sample dishes—like cayenne and tart cherry brownies—are provided to suggest how the flavors might be integrated into their product lines.

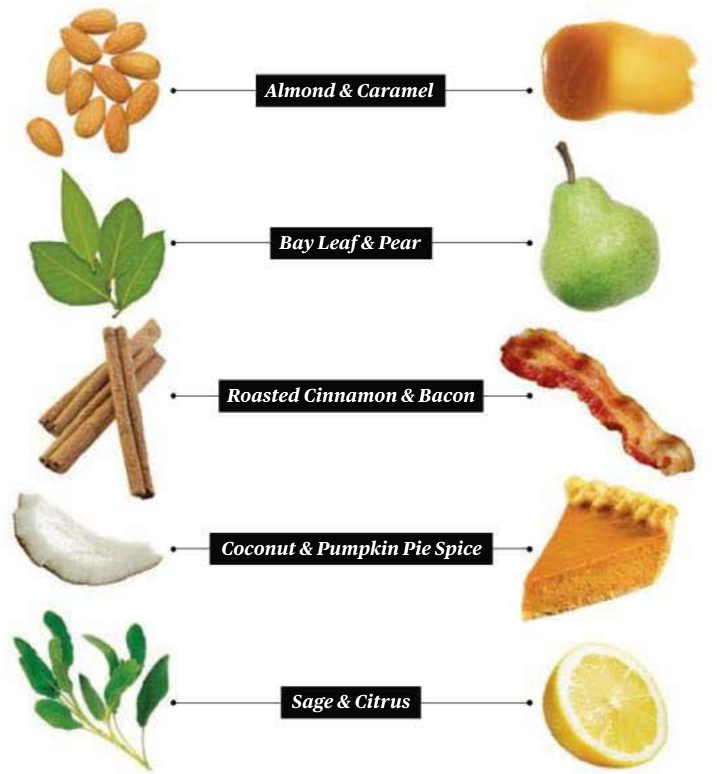
"That's one of the big values," says Doug Hasselo, chief food innovation officer with KFC, owned by Yum! Brands. "They'll take trends and research, and apply that into prototypes and concepts that we might pursue." Hasselo says the McCormick presentations' consumer research makes it easier for KFC to commit resources to developing prototypes based on the company's products, such as the seasoning for Kentucky Grilled Chicken.

To be successful, flavors must be versatile. "It has to be a broad enough pairing to hit multiple places in a menu," says Vetter, noting that the best pairings work in at least three categories, such as a dessert, savory main, appetizer, snack, or cocktail. For the special 2010 Holiday Forecast, Vetter honed in on pumpkin spice, breaking down the ingredients—cinnamon, ginger, nutmeg, allspice—to reveal flavors common in Latin and Caribbean dishes, such as jerk chicken. Since those dishes often require coconut milk, a potential pairing was born.

CLOCKWISE: JONATHAN KANTOR/GETTY IMAGES; RICHARD JACKSON/AGE FOTOSTOCK AMERICA; IMAGE SOURCE/GETTY IMAGES; ADRIANNA WILLIAMS/CORBIS; JUDD PILOSSOF/GETTY IMAGES; LAUREN BURKE/GETTY IMAGES; DORLING KINDERSLEY/GETTY IMAGES; LAWTON/SOFOOD/CORBIS; JAMES WORRELL/STOCKFOOD; STEVEN MORRIS/STOCKFOOD

The Acquired Tastes

Vetter's flavor pairings for his 2010 holiday forecast



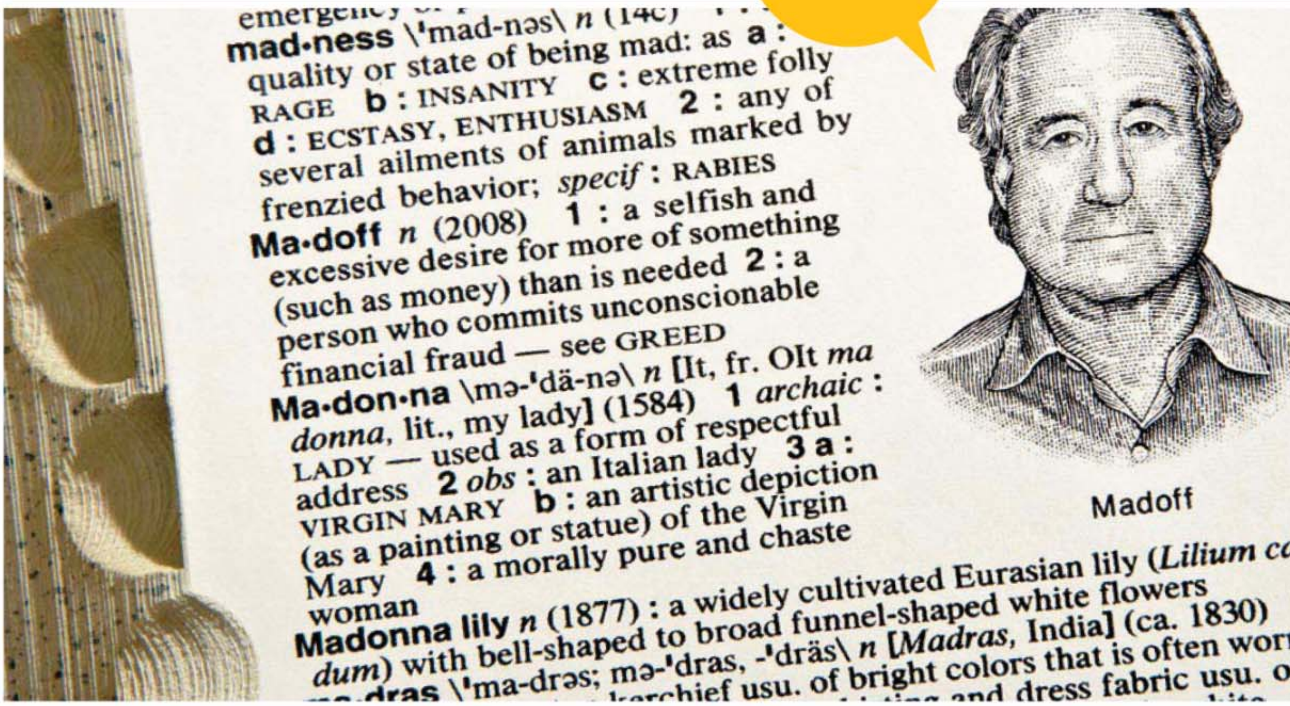
"Eight years ago, people couldn't even pronounce chipotle!" says Vetter of his 2003 selection

After concocting pumpkin pie spice and coconut milk rubbed short ribs, pumpkin spiced coconut fudge, and a pumpkin whoopee pie with coconut cream filling, he decided the pairing made the cut. It joined bay leaf and pear, almond and caramel, sage and citrus, as well as roasted cinnamon and bacon in rounding out the yuletide forecast. "What the report reflects," Vetter says, "is how the holiday is evolving."

For McCormick, evolution is good for business. The company has launched a report for the Chinese market—which includes flavor combinations such as avocado and blueberry—and one for Europe (mint and courgette, anyone?). Since McCormick acquired a stake in the Indian company Eastern Condiments in June, expect to see Vetter's combinations popping up in the fast-food outlets and supermarkets of Mumbai and New Delhi over the coming years.

Despite his influence, Vetter remains modest. During a recent visit to a restaurant in Anaheim, Calif., he noticed a cocktail with watermelon and basil, one of his signature combinations. "This almost validates what we're doing," he says. "I feel pretty pleased I called that trend." Ⓑ

Madoff may have redefined greed, but he hardly has a corner on the market



Always Remember The Greediest

Can studying centuries of Ponzi crooks help stave off the next recession? *By Devin Leonard*

After pleading guilty to defrauding his clients of billions, Bernie Madoff told investigators how he became a crook in the first place. Apparently, the Ponzi artist lamented, he'd suffered embarrassing losses with a European bank in the early '90s. Instead of confessing this to his clients and blemishing his reputation, Madoff began generating fake returns. Once he started, he explained, it was just too hard to stop. "I wish they caught me six years ago, eight years ago," he sighed.

There's a name for this kind of embarrassment. One $65 billion Ponzi scheme later, the word "Madoff" translates into "greed" in any number of languages. So much so that most readers won't need to scan the subtitle of David E.Y. Sarna's *History of Greed: Financial Fraud from Tulip Mania to Bernie Madoff* to guess which noteworthy figure dominates its pages. And although Sarna, a former high-tech executive who maintains the popular blog greedwatcher.com, spends a quarter of his book dissecting the Madoff scandal, the most important lessons come from greed's distant past.

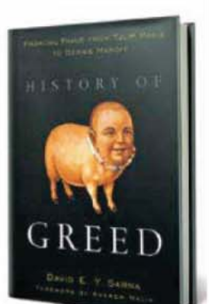
Sarna begins his history with the creation of naked short-selling at the world's first stock exchange in Amsterdam. In 1609, Dutch merchant Isaac Le Maire assembled a secret society to place bets that Holland's Dutch East India Company would tumble. How was he so sure? He wasn't, really, but he was trying to start a French charter company to compete with it. Once the news of the bets against the company got out, its shares plummeted. Le Maire made a killing–not only shorting the stock but also doing it with shares he hadn't borrowed. When the government caught on, it banned short-selling altogether–a fitting start to a historically divisive practice.

Think AOL broke ground using inflated stock to snap up Time Warner in 2000? In the 18th century, Scottish financier John Law persuaded the French government to grant him exclusive fur and mineral trading rights in its New World territories. This allowed Law to sell shares in his Mississippi Company and extend his tentacles to Africa, China, and East India.

i

History of Greed: Financial Fraud from Tulip Mania to Bernie Madoff

by David E.Y. Sarna
(WILEY, 416 pages, $29.95)



TOP: PHOTOGRAPH BY FREDRIK BRODEN FOR BLOOMBERG BUSINESSWEEK

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Law was the toast of France, until shares collapsed and the Scotsman, in full drag, fled for his life.

As Sarna shows, financial villains have weaved through history for centuries, but none actually causes booms or busts. The real threat is that, as the economy has become global, greed has been democratized. Any speculator with a bank account now has the chance to make a quick buck. Colorful characters like Le Maire have given way to inelegant crooks like "Crazy Eddie" Antar, the megalomaniac electronic chain store owner who went to jail in 1997 for bilking his company. He gets his own chapter here. The author is similarly fascinated with Lou Pearlman, the former manager of the Backstreet Boys, who's now serving 25 years in prison for a Ponzi scheme involving phony airline and travel businesses.

Sarna parses his given subject with the distinction between "immoral" and "criminal" greed. While the immoral variety is bad, he writes, the higher-proof stuff is what sparks economic calamities like the Great Recession. He explains our current predicament by declaring, somewhat clumsily, "Greedy financial promoters, investment bankers, and their cohorts and all-too-willing accomplices were all allowed to run unchecked."

Alas, if only Sarna had read his own history. In 1630s Holland, he writes, chimney sweeps and noblemen alike obsessively bought tulips as the flower's price soared. When the music stopped, nearly all lost their ruffled shirts. Four centuries later, millions of Americans from various tax brackets invested their life savings in homes they couldn't afford and financial transactions they didn't understand. Sarna believes that by studying Le Maire and Madoff we can prevent the next Allen Stanford—and subsequent economic catastrophes. However, if history proves anything, these fraudsters aren't the real problem.

Yet Sarna has good reason to believe the human foibles that have wreaked financial havoc on us all these years can be corrected. *History of Greed*'s book jacket neglects to mention that he pleaded guilty in 2006 to conspiring to commit securities fraud and served nine months in jail. Had the author interviewed himself, he might have gained valuable insight into what sparks already wealthy people to take risks—even illegal ones—to enhance their coffers. When I asked Sarna why he omitted such a significant biographical detail, he confessed that his wife asked him to. Like Bernie, she was simply embarrassed. **B**

The Pantheon Of Greed Gods

A brief history of the prolific proprietors of financial avarice

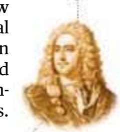
1609



Isaac Le Maire
Invents short-selling on the Amsterdam Stock Exchange and loses his shirt.

1720

John Law
Creates a global trading empire in France with inflated stock. Flees the country after it implodes.



1856



John Sadler
British banker poisons himself after siphoning huge sums from his brother's bank, causing it to collapse.

1903

William "520 Percent" Miller
Earns nickname promising weekly 10 percent returns before being busted.



1920



Charles Ponzi
Pleads guilty to bilking thousands in a shady postage stamp investment scheme.

1992

"Crazy Eddie" Antar
Apprehended in Israel after being indicted for running his electronics chain as a criminal enterprise.



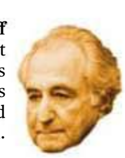
2006



Lou Pearlman
Boy band impresario is jailed for persuading clients to put their cash into a phony airline business.

2008

Bernie Madoff
In history's biggest Ponzi scheme, rips off such A-listers as Steven Spielberg and Mort Zuckerman.



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Azim Premji

“It probably took me about 300 hours to complete the course work over four or five months, but I was determined not to take time away from the company”

The chairman of Indian IT conglomerate Wipro on dropping out of Stanford, building his company, and finally completing his degree



My father died at the age of 51, when I was a student at Stanford University. As the male head of the family, I had to rush back home. At 21, I was appointed chief executive of the small company he'd formed, Western India Vegetable Products.

I thought I could still graduate, but I got too sucked into the business. At the first shareholders' meeting, someone stood up and said: “Young man, my strong advice is that you sell your shares to a more mature holder. There's no way you can run a complex company like this.” I was nervous, but I held on. It was a small company at the time that made cooking fats. We converted it to a consumer care company with branded products. Then we diversified into IT products and then to IT services for the global market.

About 15 years back, I got tired of being a dropout. I petitioned the engineering committee at Stanford to allow me to finish the remaining 21 or so credits by correspondence. They agreed. It probably took me about 300 hours to complete the course work over four or five months, but I was determined not to take time away from the company. I would work very early in the morning, late at night, and on weekends. I wasn't sure I had made the grade. But when a senior electrical engineering professor at Stanford contacted me to say I had, it felt so satisfying to know an incomplete job was now complete. I put the degree in my office.

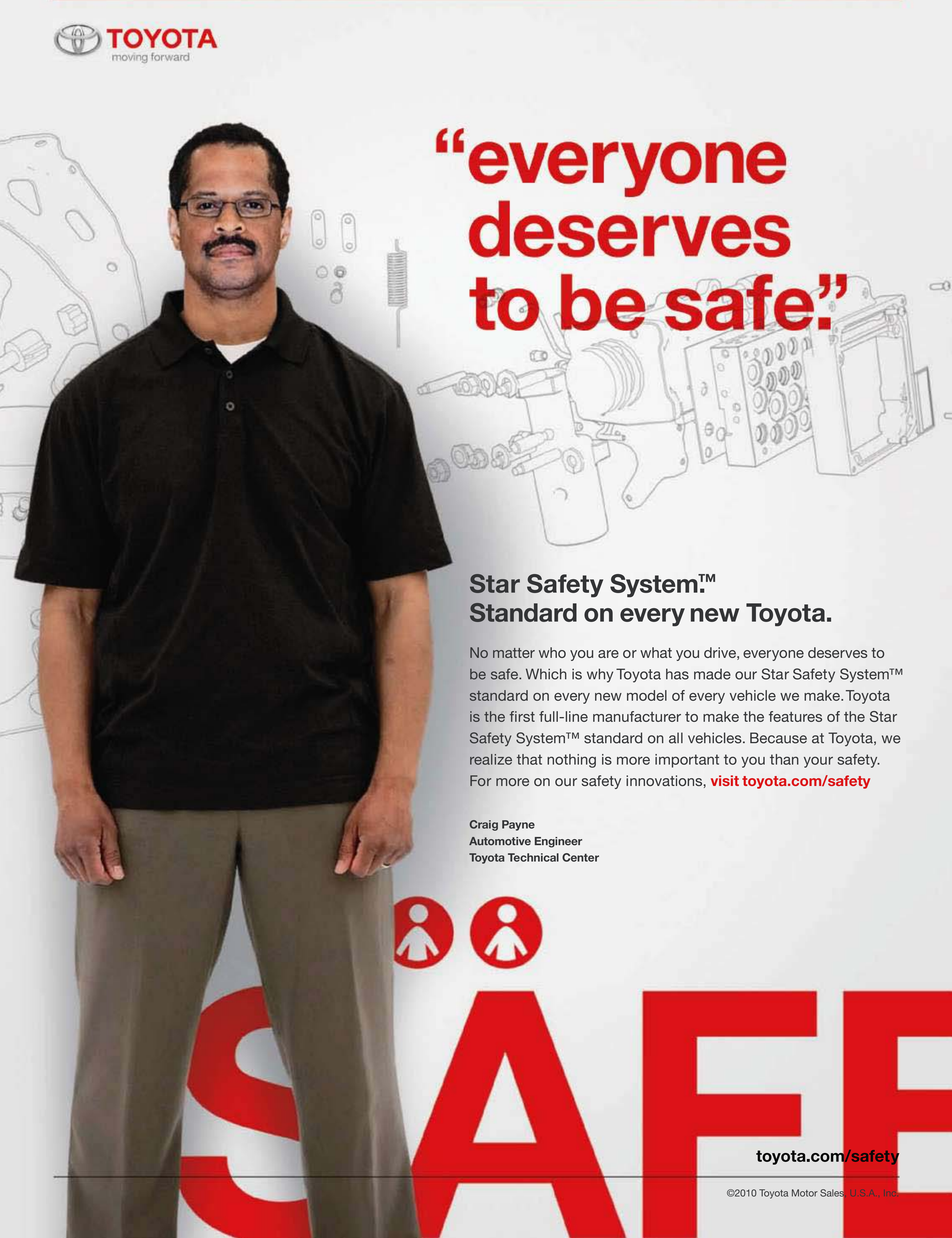
If I was a young person today, I would still go to a good U.S. school. The Indian schools can be very narrow and technical: It's engineering, engineering, engineering. Foreign schools give you a broad experience with your engineering degree. The cultural experience I got in the U.S. was useful: It's expensive but it's worth it.

If my father had not died, I probably would have stayed in the U.S. and completed a master's degree. Then I would have liked to work for an organization like the World Bank for a few years before coming back. But I have no regrets. It took me a long time, but I finished. —*As told to Diane Brady*

PHOTOGRAPH BY MIKE MCGREGOR FOR BLOOMBERG BUSINESSWEEK

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